RECEIVED
04 JAN 20 AM 8:58
OFFICE OF THE SECRETARY
FEDERAL MARITIME COMM

Before The
FEDERAL MARITIME COMMISSION

DOCKET NUMBERS:

Petition No. P3-03 –	**Petition Of United Parcel Service, Inc. For Exemption Pursuant To Section 16 Of The Shipping Act To Permit Negotiation, Entry And Performance Of Service Contracts**
Petition No. P5-03 --	**Petition of National Customs Brokers And Forwarders Association Of America, Inc. For A Limited Exemption From Certain Tariff Requirements Of The Shipping Act**
Petition No. P7-03 --	**Petition Of Ocean World Lines, Inc. For A Rulemaking To Amend And Expand The Scope Of "Special Contracts"**
Petition No. P8-03 --	**Petition Of BAX Global Inc. For Rulemaking**
Petition No. P9-03 --	**Petition Of C.H. Robinson Worldwide, Inc. For Exemption Pursuant To Section 16 Of The Shipping Act To Permit Negotiation, Entry And Performance Of Confidential Service Contract**

FURTHER COMMENTS OF AMERICAN PRESIDENT LINES, LTD. AND APL CO. PTE., LTD. IN REPLY TO THE PETITIONS

Robert T. Basseches
David B. Cook
Eric C. Jeffrey
SHEA&GARDNER
1800 Massachusetts Ave., N.W.
Washington, D.C. 20036

January 16, 2004

TABLE OF CONTENTS

I. INTRODUCTION

Pursuant to the Commission's November 13, 2003 orders, American President Lines, Ltd. and APL Co. Pte., Ltd. ("APL" or "APL Liner") submit these further comments in the following dockets:

Petition No. P3-03 -- Petition Of United Parcel Service, Inc. For Exemption Pursuant To Section 16 Of The Shipping Act To Permit Negotiation, Entry And Performance Of Service Contracts ("UPS");

Petition No. P5-03 – Petition of National Customs Brokers And Forwarders Association Of America, Inc. For A Limited Exemption From Certain Tariff Requirements Of The Shipping Act ("NCBFAA");

Petition No. P7-03 -- Petition Of Ocean World Lines, Inc. For A Rulemaking To Amend And Expand The Scope Of "Special Contracts" ("OWL");

Petition No. P8-03 -- Petition Of BAX Global Inc. For Rulemaking ("BAX");

Petition No. P9-03 -- Petition Of C.H. Robinson Worldwide, Inc. Pursuant For Exemption Pursuant To Section 16 Of The Shipping Act To Permit Negotiation, Entry And Performance Of Confidential Service Contract ("CHRW").

These further comments supplement APL's October 10, 2003 reply comments in the above-listed dockets, which are incorporated herein by reference. APL's 10/10/03 Comments (i) identified important policy/fact issues that are raised by the petitions, which we believe the Commission has a responsibility to investigate and evaluate, and (ii) explained why the Commission lacks statutory authority to grant the relief sought by the petitions.

The policy issues identified in APL's 10/10/03 Comments were ignored in the simultaneously filed comments of others; and there is thus nothing for us to reply to on those matters. Nonetheless, because we believe that the policy/fact issues are fundamentally important and because the Commission's 11/13/03 orders afford an opportunity for additional comments on the original petitions, APL has taken the opportunity to further identify and develop the policy/fact issues. Specifically, APL retained Reeve & Associates to consider the policy implications of petitioners' proposals and to prepare a written report for submission to the Commission. Reeve & Associates is a management consulting firm specializing in international trade, transportation and logistics, whose clients include major shipping companies, port authorities, marine terminal operators, shippers, and government organizations.[1/]

The Reeve & Associates report, entitled "Important Questions Raised By Petitions To The Federal Maritime Commission Concerning Non Vessel Operating Common Carriers and Service Contracts" ("Reeve Rept."), is appended hereto. It explains that the petitioners' proposals could have serious adverse effects on the financial viability and basic structure of the VOCC industry, by allowing "mega-NVOs" to aggregate enormous economic power which they could use to relegate VOCCs, to a significant extent, to the status of wholesalers of an undifferentiated commodity (vessel space) to mega-NVOs rather than retailers of transportation service to shippers. It also explains that these effects on the VOCC industry could in turn give rise to significant adverse effects on (i) the adequacy of future investment in vessel capacity, marine terminals and other maritime infrastructure, (ii) rate levels paid by shippers, (iii) innovation in the maritime industry, and (iv) U.S. national security.

Since at this stage of the proceeding we have not had an opportunity to see (much less respond to) comments of other parties on these policy issues, and given the relatively short

---

[1/] Reeve Rept. pp. 4-5. The resume of John G. Reeve, President of Reeve & Associates and principal author of their report, is an appendix to that report. While APL is sponsoring the Reeve Report and strongly endorses it, it should not be assumed that APL necessarily agrees with every particular statement or bit of data in it.

time period allowed for supplemental comments, we did not request Reeve & Associates to attempt to reach firm conclusions on these issues. Indeed, the Reeve Report finds that firm conclusions are not possible at this point, because important facts are not available. APL believes that it is the Commission's responsibility to initiate a proceeding for the purpose of developing those facts and making a full policy evaluation. The Reeve Report contains more than enough facts and analysis to establish that the policy concerns it identifies are not hypothetical, but very real and very serious, and that it is therefore necessary for the expert agency to undertake an in depth investigation and analysis. As explained in APL's 1 0/10/03 Comments (pp. 3-4, 27-28) and below (pp. 38-39), the Commission has the authority -- and the responsibility -- to undertake such an investigation and analysis regardless of how it decides the legal issue of whether it has statutory authority to take the actions petitioners request.

With respect to that legal issue, we established in APL's 1 0/1 0/03 Comments that the Commission lacks statutory authority, under its Section 16 exemption power or otherwise, to effect the fundamental changes being sought by the petitioners to the 1984 Act regulatory regime. There was no meaningful consideration of this issue either in the original petitions filed with the Commission or in the comments supporting the petitions filed concurrently with APL's 10/10/03 Comments. (The legal issues were carefully addressed in the 10/10/03 comments filed by APL and the World Shipping Council.) After addressing in Part II of these Further Comments the issues relating to the policy implications of the petitioners' proposals, we respond in Part III to the limited analysis on the legal issues in the 10/10/03 and subsequent filings of the petitioners and supporting NVOCCs -- none of which supports a conclusion at variance with that of APL's 10/10/03 Comments.

II. THE FUNDAMENTAL POLICY/FACT ISSUES THAT MUST BE FULLY ADDRESSED BY THE COMMISSION

A. The Entities Involved And Their Competitive Relationships

Petitioners' proposals raise issues that go to the heart of competition in the shipping industry and the basic structure of that industry. In order to understand these issues, it is necessary to understand the nature of the competing entities and their competitive relationships.

Petitioners United Parcel Service, Inc. ("UPS"), BAX Global Inc. ("SAX"), and C.H. Robinson Worldwide, Inc. ("CHRW") operate logistics companies that provide comprehensive "supply chain management" and other logistics services to shippers. The supply chain management services can include, not only ocean transportation, but also a wide range of non-transportation activities that have not historically been subject to Shipping Act regulation or FMC supervision, ranging from worker training and quality control at a factory in a foreign nation to unpacking individual consumer goods and placing them on the retail shelf.' Petitioners' logistics companies also operate as non-vessel operating common carriers ("NVOCCs" or "NVOs").[3] There are at least nine other very large logistics/NVO companies, similar to petitioners, which are operating in the U.S. foreign trades but which have not filed petitions (to date). Reeve Rept. pp. 9-10.

---

[2] See APL 10/10/03 Comments pp. 5-6.

[3] The petitions are not always clear whether the logistics company itself is an NVO or whether the NVO is a corporate affiliate. It makes no difference for present purposes, since the petitions make clear that the logistics and NVO operations are tightly integrated. See UPS Petition pp. 4-7, 15; Gargaro Decl. pp. 12-17; OWL Petition pp. 3-4 & n.2; BAX Petition pp. 6-8; CHRW Petition pp. 4-5; Mulvehill Decl. pp. 2-3.

Petitioners' logistics/NV0 operations are involved in three different sets of relationships that affect competition in the maritime industry. (a.) Petitioners' logistics companies compete with other logistics companies for shippers' business in providing supply chain management services. (b.) Petitioners' NVO operations compete with vessel-operating common carriers ("VOCCs"), as well as with other NVOs, for shippers' business in providing the ocean transportation piece of supply chain management as well as for shippers' regular ocean transportation business. (c.) Petitioners' NVO operations deal with VOCCs in purchasing ocean transportation service which they resell to their NVO customers.

1. Competition Between Logistics Companies. With respect to the competition between petitioners' logistics companies and other logistics companies -- including logistics companies affiliated with VOCCs, such as APL's sister company APL Logistics, Ltd -- all of the facts available to us indicate that there is no unfair competitive advantage and no regulatory impediment to efficient operations under the existing regulatory regime. In its 7/25/03 petition, UPS alleged (i) that a VOCC-affiliated logistics company such as APL Logistics has an unfair competitive advantage over UPS' logistics company because logistics services are merged into the VOCC's Shipping Act service contracts, and (ii) that without the ability to enter into service contracts with shippers, it is impossible for UPS to enter into a confidential agreement that comprehensively covers a customer's supply chain management.[4] However, as explained in APL's 10/10/03 Comments (pp. 7-9), both of these claims are incorrect.

---

[4] See, e.g., UPS Petition pp. 7, 11-12; Gargaro Decl. p. 20.

· Under the current regulatory regime, it is entirely possible for a logistics company to construct a comprehensive supply chain management contract that includes confidential ocean rates. A VOCC is not party to the contract. Rather, the logistics company contracts directly with the customer. The portions of the contract dealing with non-ocean logistics services are confidential (and are not filed with the FMC). The portion of the contract dealing with ocean transportation can also be kept confidential, by providing that cargo subject to the contract will be moved pursuant to specified service contracts between the customer and specified VOCCs. The logistics contract typically provides that the logistics company will act as the customer's agent in tendering/receiving cargo to/from the VOCCs under such service contracts. The service contracts used can be negotiated with the VOCC by the customer directly or, if the customer desires, by the logistics company acting as the customer's agent.[5/]

· It is commonplace for logistics companies in the major U.S. trades to use arrangements of the above-described type to put together comprehensive, confidential supply chain management contracts.[6/] APL Logistics operates in this manner. APL Liner service contracts do not cover supply chain services to be performed by APL

5/ When public NVOCC tariff rates are appropriate in the business context (which is often the case), the logistics contract can provide for the use of NVO tariffs in addition to or in lieu of service contracts.

6/ See APL 10/10/03 Comments pp. 8-9.

Logistics, which are instead covered by contracts between APL Logistics and its customers, of the above-described type, to which APL Liner is not a party.1

- Logistics contracts between VOCC-affiliated logistics companies and their customers typically provide for the use of a number of different service contracts between the shipper and a number of different VOCCs (not just the affiliated VOCC). VOCC-affiliated logistics companies are required by their customers to act in the customer's best interests, and the choice of VOCC for particular shipments is made based on overall value to the customer based on departure date, transit time, etc., as well as cost.[8/]

- Petitioners themselves attest that their logistics businesses have grown dramatically in just a few years.? The Reeve Report identifies that the revenues of twelve major non-VOCC-affiliated logistics service providers (including UPS, CHRW and BAX) are growing twice as fast as the revenues of the liner shipping companies and are fast approaching total global liner revenues in absolute value, and that their individual cargo volumes may amount to hundreds of thousands of TEUs annually. The Report aptly refers to these entities as "mega-NVOs." Reeve Rept. pp. 9-10.

7/ See APL 10/10/03 Comments pp. 8-9.

8/ See Reeve Rept. pp. 13-14; CHRW 9/12/03 petition pp. 16-17. In addition, logistics companies affiliated with VOCCs tend to operate as independent profit centers and usually deal with their affiliated VOCC on an arm's length basis. Reeve Rept. p. 14.

9/ UPS Petition pp. 4-7; Gargaro Decl. pp. 12-14; BAX Petition pp. 6-8; Donahue Decl. ¶¶ 14-27; CHRW Petition pp. 4-5, 8-10; Mulvehill Decl. pp. l-3; Lindbloom Decl. pp. l-2.

The above facts indicate that the current regulatory regime is not inhibiting the development of the logistics industry in general or causing unfair competition to non-VOCC-affiliated logistics companies in particular. If petitioners or others were to allege contrary facts in their January 16, 2004 comments, the issue could be considered in a further Commission proceeding (see pp. 38-41 below).

2. Competition Between VOCCs and NVOs. In addition to the just-discussed competition between petitioners' logistics operations and VOCC-affiliated logistics companies for supply chain management business, there is a separate competition between the petitioners' NVO operations and VOCCs for ocean transportation business (whether performed as part of a supply chain management package or otherwise). In order to evaluate the implications of petitioners' proposals on this NVO/VOCC competition for ocean transportation business, it is important to identify the basic differences between the two types of entities.

a. The differences between VOCCs and NVOs. The VOCC industry is highly asset intensive -- much more so than the logistics/IWO industry. Reeve Rept. pp. 7-8, 17-18. In order to be a major VOCC in the U.S. trades, a company must invest heavily in physical assets for <u>maritime</u> transportation and <u>maritime</u> infrastructure -- including vessels, marine terminals and terminal equipment, ocean containers and chassis, and intermodal systems for cargo moving on a VOCC's ocean/land through bill of lading. Reeve Rept. pp. 14-15, 17, 25-26.[10] The magnitude of a major VOCC's investment in maritime assets is huge,

---

[10] As UPS acknowledged in its December 2, 2003 Oral Presentation to Commissioner Brennan, an attempt by a large NVO to achieve the status of a major VOCC by a token investment in maritime assets would raise serious legal issues and almost certain legal challenge.

(continued...)

both absolutely and in relation to its gross revenues. In 2002, for example, APL's investment in ships, wntainers, terminals and other operating equipment was valued at $3.2 billion, compared to total revenues of $4.6 billion. Maersk Sealand's investment in similar maritime assets was $6.9 billion compared to total revenues of $11.6 billion. Reeve Rept. pp. 25-26.

A major VOCC's heavy investment in vessels and maritime in&structure results in high burdens and risks. This is especially true in the principal U.S. trades, in which a VOCC's maritime assets are -- half the time -- severely underutilized in backhaul service that does not wme close to covering the carrier's costs (a condition that has become much worse in recent years as U.S. east/west trade imbalances have greatly increased). Reeve Rept. pp. 21-23. Due in part to the inability to recover costs in the backhaul trades, the financial returns of major VOCCs have been plainly inadequate in recent years. Reeve Rept. pp. 18, 23.[11/]

NVOs, in contrast, make no investment whatsoever in maritime assets and maritime infrastructure. Reeve Rept. pp. 18, 22, 25. The listing in UPS' petition of its physical assets (airplanes, parcel delivery trucks, buildings and the like[12/]) merely serves to highlight the fact that even very large "asset-based" NVO/logistics companies make no investment in ocean vessels, ocean wntainers, or marine terminals and related maritime infrastructure. Unlike VOCCs, NVO/logistics companies do not bear the risks and burdens of such investments.

[10/] (...continued)
December 5, 2003 Summary of Presentation p. 2.

[11/] The fact that 2003 was apparently a good year for the VOCC industry does not negate the fact that their returns over time have been low by established financial measures.

[12/] UPS petition p. 14; Gargaro Decl. pp. 2, 3.

In particular, NVOs do not suffer the consequences of backhaul ocean service that does not cover costs. Because NVOs do not invest in maritime assets, they are free to concentrate on competing with VOCCs for higher revenue, higher margin cargoes in the headhaul trades, while leaving the VOCCs to bear the entire burdens of the backhaul trades. Indeed, to the extent that the NVOs do business in the backhaul trades, they benefit from the severely depressed VOCC rate levels. Reeve Rept. p. 22.

Through rapid growth and successes in competing with VOCCs for shipper customers, the major NVOs have obtained enormous cargo volumes. For example, UPS' ocean volumes now approximate those of Wal-Mart, which is by far the largest beneficial-cargo-owner shipper in the U.S. trades. Reeve Rept. p. 9. Although there is a need for better data, it appears that other mega-NVOs may have ocean cargo volumes that are similar in magnitude to those of UPS. Reeve Rept. pp. 9-10. This gives them great bargaining power in rate negotiations with VOCCs -- under the <u>current</u> regulatory regime about which they complain. Reeve Rept. pp. 8-9, 11-12.

In these circumstances, it is not surmising that the financial returns of the major NVOs have been generally high, and far higher than the financial returns of the major VOCCs. Reeve Rept. p. 18.

b. The relevance of the differences between VOCCs and NVOs and the "level playing field" argument. The regulatory regime established by Congress in the Shipping Act allows VOCCs, but not NVOs, to enter into service contracts with shippers. This provides a benefit to VOCCs in their competition with NVOs for shippers' ocean transportation **business,**[13] and APL would not be filing these wmments if it did not believe that benefit to be important.

The petitioners and some of the wmmenters essentially argue: VOCCs compete with **NVOs** for shippers' business; the Shipping Act provides the benefit of service contracting to VOCCs but not to **NVOs;** that creates a playing field that is not level; non-level playing fields are bad, therefore, **NVOs** should be allowed to enter into service contracts with shippers. Although perhaps superficially appealing, this argument is overly simplistic because it ignores the above-described basic differences between VOCCs and **NVOs,** and in doing so begs the real questions.

The "level playing field" argument assumes that there are no relevant differences between the competitors that justify different treatment. Here, VOCCs and **NVOs** come to the playing field bearing very different burdens. The VOCCs wme to the field bearing the enormous burden of investments in maritime assets (without which it would not be possible to play the game) that results in traditionally low returns by established **financial** measures. In contrast, the **mega-NVOs** piggyback on the VOCCs' investment, are able to cherry-pick the higher revenue trades, and are highly profitable.

Moreover, even though the VOCCs paid for and own the stadium and the ball, they are required by the Shipping Act to let the **NVOs** use them. *I.e.*, unlike the normal situation in American business -- where a provider of goods or services is generally free to choose to sell its product to consumers exclusively on a direct retail basis, and thus to refuse to allow

---

[13] As distinct from the competition between VOCC-affiliated logistics companies and other logistics companies for logistics business (see pp. **5-8** above).

middlemen onto its playing field -- the Shipping Act generally prohibits a VOCC from refusing to enter into a service contract with an NVO based on the NVO's status as a middleman that will compete with the VOCC.[14/]

In these circumstances, the "level playing field" argument begs the real questions, which include: (1) Do the great differences between VOCCs and NVOs warrant treating them differently for the purpose of entering into service wntracts with shippers? (2) If, notwithstanding the differences between them, NVOs were to be given the same service contract authority as VOCCs, what would be the effects on the maritime industry and on national policies relating to the maritime industry?

APL's position is that it and other VOCCs have paid a steep price for the right to enter into service contracts with shippers, by investing billions of dollars in vessels, marine terminals, ocean containers, and other maritime infrastructure, and by bearing the burdens and suffering the financial consequences resulting from that investment. Because NVOs have not paid that price and are fundamentally different entities, it is fully justified for APL and other VOCCs to have a competitive benefit in the form of service contract authority that is not available to NVOs.

If NVOs were authorized to enter into service contracts on the same basis as VOCCs, there would be serious risks of significant adverse consequences to the maritime industry, U.S.

[14/] Shipping Act §10(b)(10). See generally, e.g., *California Shipping Line, Inc. v. Yangming Marine Transport Corp., 24 SRR* 1213, 1221 (FMC 1990); *Co-Loading Practices of NVOCCs,* 23 SRR 123,132 (FMC 1985).

commerce, and U.S. economic and security interests. We summarize these risks below, based on the accompanying report of Reeve & Associates.

We do not ask the Commission to make findings on these policy/fact issues based on APL's comments or the Reeve Report. As noted at the outset, at this stage neither APL nor Reeve & Associates claims to have fully developed the facts or to have fully analyzed the policy issues. Only the Commission is in a position to develop the necessary factual record; and only the Commission (with input from industry participants) is in a position to perform a full policy analysis that may be viewed by the shipping public and Congress as both independent and authoritative.

APL does, however, strongly believe that the Reeve Report and these comments clearly show that there are real reasons to be concerned that petitioners' proposals would have significant adverse impacts on important national policies. At this stage, that showing is sufficient -- indeed dispositive -- on the need for the Commission to initiate a further proceeding to investigate the relevant facts and comprehensively analyze the issues.

B. Potential Effects On VOCCs' Competitive Position And Long-Term Viability, And On The Structure Of The VOCC Industry

The current balance of competitive power between VOCCs and NVOs is a function both of the differences between the two types of entities and the Shipping Act regulatory regime. The current balance is not one in which VOCCs have the upper hand. To the contrary, the mega-NVOs are earning much better returns and growing their businesses much more rapidly. Reeve Rept. pp. IO-1 1, 17-18.

If the current regulatory regime were changed by allowing **NVOs** to use service wntracts, one of the major determinants of the current competitive balance would significantly change. This **could** result in a significant **shift** in the competitive balance **further** in favor of the **mega-NVOs** and further against the VOCCs. Reeve Rept. pp. 1 I-15.

The **mega-NVOs** already have very great bargaining power in negotiating rates with VOCCs due to their very large cargo volumes. Seep. 10 above and Reeve Rept. pp. 8-9, 1 1-12. Allowing them to enter into service contracts with shippers would enable them to accumulate even more bargaining power. Today, when service contracts are used to provide the ocean piece of supply chain management, the service contracts are between individual VOCCs and individual shippers, and the rates reflect the individual shippers' volumes and other circumstances. See pp. 5-6 above. If the **mega-NVOs** are allowed to enter into service contracts with shippers, they will be able to aggregate the volumes of numerous additional shippers -- on top of their already huge volumes -- and use the enormous aggregated volume to negotiate homogenized "mega-service contracts" with VOCCs. They will be well positioned to do so because, as the single manager of a shipper's supply chain, they would have the exclusive direct relationship with the customer and deal with all cargo in the supply chain. Reeve Rept. pp. 11-13, 15.

The result **could** be to significantly drive down the prices that the **mega-NVOs** pay VOCCs for ocean transportation services provided to the **mega-NVOs.** Reeve Rept. pp. 1 l-13, **16.**[15] This result would be facilitated by the fact that some VOCCs -- particularly **state-**

---

[15] While some might think this would be a public benefit because it would result in lower
(continued...)

controlled, low-service VOCCs -- are heavily dependent on NVOs to perform the sales and marketing functions that high-service VOCCs perform with their own sales forces. By using their leverage with the state-controlled or subsidized VOCCs, the mega-NVOs could force other VOCCs to reduce their rates (and in consequence their financial returns). Reeve Rept. pp. 12-13.

In addition, the above-described increase in mega-NVO volumes and bargaining power wuld result in significant "disconnection" of VOCCs from direct relationships with their customers, i.e., as the mega-NVOs controlled more and more cargo, they would to a significant extent supplant VOCCs as the entities with direct shipper relationships. Reeve Rept. pp. 12, 16. Such circumstances would give rise to a real possibility that the liner shipping industry would become "commoditized" to a significant degree. *I.e.*, VOCCs could be essentially relegated to the role of wholesalers in selling large amounts of fungible space, essentially as a basic commodity, to very large buyers (the mega-NVOs). The historical movement of the VOCC industry in developing value-added services beyond simple port-to-port transportation would be reversed. In the competition among VOCCs to survive as a seller of vessel space as an undifferentiated commodity, low cost would be critical, because the mega-NVOs would likely seek to purchase the commodity at the lowest possible price. VOCCs would compete with each other on that basis, and a VOCC's ability to provide value-added services to shippers would become a much less important factor in competition among VOCCs. Reeve Rept. p. 16.

15/ (...continued)
transportation prices for beneficial cargo owners, the opposite would likely be true. See Reeve Rept. pp. 15-16 andpp. 17-18 below.

In such a competitive environment, the advantage would lie with VOCCs that have access to very low cost labor and substantial government subsidies and support. The likely winners would be lines that are controlled by foreign governments and/or that receive direct and indirect subsidization of their operations to advance foreign governments' national interests and economic policies.[16] The likely losers would be lines that must compete in open markets for investment capital and sustain an adequate return on capital while paying fair market prices for labor and other cost items. U.S. foreign wmmerce could become increasingly dependent on such foreign government-controlled or foreign government-subsidized lines. Reeve Rept. p.16.

The above developments could have serious adverse effects on important U.S. national policies, as explained in the Reeve Report and summarized below.

C. **Potential Effects On The Adequacy Of Vessel Capacity And Maritime Infrastructure, And Related Effects On Shippers**

In order to be a major player in the liner shipping industry, a VOCC must make very large investments in physical maritime assets such as vessels, containers, and marine terminals. See pp. 8-9 above; Reeve Rept. pp. 14-17, 25-26. Under the current regulatory regime, the VOCCs' returns on their existing investments have been low by established financial measures. See p. 9 above; Reeve Rept. p. 18. If petitioners' proposals were to result (for the reasons suggested above) in a further reduction in VOCCs' actual or anticipated returns, it is reasonable to expect that a number of VOCCs would decide to leave the industry, or at least to

[16] The Maritime Security Program, which offsets only part of the higher cost of operating U.S. flag vessels, does not produce such a cost advantage. See Reeve Report p. 16 n.11.

limit their exposure by cutting back on future investments. In the long term, this could result in shortages in vessel capacity, containers and/or marine terminal capacity that would be detrimental to shippers and to U.S. commerce. Reeve Rept. pp. 17-24.

The available data confirm that VOCCs (at least those that function in a free market environment subject to the normal requirements for adequate return on capital) generally cut back on ordering new vessel capacity during periods when returns decrease, even if trade volumes are increasing. Reeve Rept. pp. 23-24. The available data also show (and the Commission recognized in its 2001 OSRA Report) that rate levels in the principal U.S. trades are to a significant degree determined by the relationship of containership capacity supply to containership capacity demand. Reeve Rept. pp. 19-21; FMC, The Impact Of The Ocean Shipping Reform Act of 1998, pp. 10, 11, 13, 14, 28 29 (Sept. 2001).

In combination, these facts indicate that it may reasonably be anticipated that (i) a prolonged period of depressed returns in the VOCC industry could result in a long-term shortage of new vessel capacity, and (ii) the resulting tightness of the capacity supply/demand relationship could increase rate levels ultimately paid by shippers. Given the high profit margins to which the mega-NVOs are accustomed, they would likely pass on to their customers any increases in what they pay VOCCs for space. Rate levels paid by shippers could also increase due to reduced competition in the "retail" market for ocean shipping service, if the enhanced competitive power of the mega-NVOs were to cause VOCCs and smaller NVOs to leave that market. Reeve Rept. pp. 15-16.

In short, although it might seem at first blush that, if the mega-NVOs use their enhanced market power to force down the rates they pay VOCCs, the ultimate shipper would benefit in the form of lower rates, that would not necessarily be the outcome. The mega-NVOs -- which are accustomed to much higher profit margins than VOCCs -- could decide not to pass any cost savings on to the shipping public. And tighter capacity and reduced competition could actually increase rates for shippers. Reeve Rept. pp. 15-24.

Further, if changes in competitive conditions make VOCCs reluctant to risk additional investments in maritime assets, the risk aversion would apply, not only to investments in vessels, but also to investments in marine terminals and ocean containers. This could result in deteriorations in vessel service, schedule reliability and marine safety. Reeve Rept. p. 16.

D. Potential Effects On Innovation In Ocean Shipping

The shipping industry, and global commerce, have greatly benefitted from a series of major innovations concerning the physical assets employed -- including the development of larger and more efficient containerships, more efficient marine terminals and cranes, double-stack rail cars, and specialized containers (such as increasingly sophisticated reefers, high cube containers, and containers tailored to the carriage of particular commodities). All of these innovations were developed by VOCCs (and APL is proud to have been in the forefront for many of them[17/]). Reeve Rept. p. 25. NVOs, which do not invest in maritime assets, have not -- and in the future cannot be expected to -- provide innovation with respect to such assets. Reeve Rept. pp. 25-26.

17/ APL's innovations include: dedicated tram service -- 1979; 45 foot containers -- 1980; real time shipment tracking -- 1984; Stacktrain -- 1984; 48 foot containers -- 1986; Post Panamax vessels -- 1988; 53 foot containers -- 1989, first global container carrier with a web page -- 1995; Internet booking -- 1996; and remote printing of bills of lading at shippers' offices -- 1996. These innovations occurred because APL had direct face-to-face contact with its customers, and could develop products and solutions that directly met their needs.

For the same reasons that petitioners' proposals could have adverse effects on the adequacy of vessel capacity and maritime infrastructure, they could wind up stifling innovation as well. Innovations such as those mentioned above require major investments in the physical assets used in international container shipping. If VOCCs become less willing to make new investments in such assets, the pace of innovation could significantly slow. Reeve Rept. pp. 25-26. In addition, much of the innovation in container shipping has been driven by VOCCs' direct relationships with beneficial cargo owners, which have allowed AF'L and other VOCCs to understand and be responsive to shippers' needs, and fostered service competition. If petitioners' proposals were to result in the disconnection of VOCCs' direct relationships with shippers, that in itself could inhibit innovation. Reeve Rept. p. 26.

E. Potential Effects On National Security

As summarized above (pp. 15-16) and elaborated in the Reeve Report, if petitioners' proposals were to result in a competitive environment in which VOCCs are disconnected from direct relationships with shippers and liner shipping becomes "commoditized," the result could well be that U.S. commerce would become increasingly dependent on the vessel services of shipping lines that are controlled by foreign governments and/or that receive direct and indirect foreign government subsidization of their operations in order to advance those governments' national interests and economic policies. That prospect, in itself, raises obvious concerns with respect to U.S. economic security.

Petitioners' proposals raise particular wncerns with respect to U.S. military security. UPS and BAX claim that there is no longer a U.S. liner shipping industry.[18] They are wrong. Although ultimately owned by foreign corporations, U.S. corporations such as American President Lines, Ltd. and Maersk Lines, Ltd. have a special status under U.S. maritime and defense statutes. They are U.S. "documentation citizens" entitled as such to own and operate U.S. flag vessels. 46 U.S.C. §12102(a). And they are among the principal participants in the Maritime Security Program ("MSP") and Voluntary Intermodal Sealift Agreement ("VISA") -- programs that the U.S. Government depends on to provide critical sealift and intermodal capabilities for the Department of Defense.

Such U.S. companies are required to have U.S. citizen-majority boards of directors and U.S. citizen principal officers, and they have U.S. citizen employees who can qualify for security clearances to participate in Department of Defense activities. They provide a level of protection of U.S. security interests that is not available from foreign companies. In particular, they make it possible to have a U.S. flag wntainership fleet and integrated intermodal systems that can be counted on to carry Defense Department cargoes in times of imminent or actual hostilities. Under the MSP program, which Congress recently re-authorized for an additional ten years,[19] U.S. companies such as APL make long-term commitments to operate a specified number of U.S. flag vessels with U.S. citizen crews, which will be available to carry Defense Department cargoes. Under the VISA program, U.S. companies such as APL commit to make

---

[18] See, e.g., BAX 10/31/03 Letter pp. 6-7; 12/2/03 Summary of Oral Presentation of UPS to Commissioner Dye; 12/5/03 Summary of Oral Presentation of UPS to Commissioner Brennan.

[19] P.L. No. 108-136, Ch. XXXV.

their intermodal transportation systems -- including ocean/land transportation, marine terminals, container equipment, and cargo tracking systems -- available to the Defense Department on a worldwide basis, with the level of wmmitment increasing, according to the scale of the military conflict, up to and including 100 percent commitment of U.S. flag vessels and key elements of the intermodal systems. Reeve Rept. pp. 27-29.

These commitments and capabilities are not hypothetical. Between them, Maersk and APL have 28 U.S. flag wntainerships in the MSP program.[20] Both companies participate in the VISA program. APL and Maersk carried (and continue to carry) enormous quantities of Defense Department cargo in support of recent and ongoing U.S. military operations in Afghanistan and Iraq. Reeve Rept. p. 27. The recent photograph on the front page of the New *York Times* of a Maersk container in flames in the Iraq desert from an attack by a rocket propelled grenade while delivering supplies to Coalition forces is a graphic reminder of the role these carriers play.

The Defense Department has recognized the vital importance of these very carriers' capabilities and participation in the MSP and VISA programs. The Commander in Chief of the U.S. Transportation Command has stated that, without them, the Defense Department would be required to spend many tens of billions of dollars to create and sustain an adequate sealift capability. Reeve Rept. p. 28.

Use of U.S. flag vessels and participation in MSP and VISA entail high cost, long-term commitments with associated high risks. There is a real question whether petitioners'

---

[20] In addition, APL has a transpacific string of five U.S.-flag vessels that are not enrolled in MSP.

proposals would jeopardize these resources. In a "commoditized" VOCC industry, VOCCs could hesitate to make such high-cost, high-risk, long-term commitments. The NVOs, who have no maritime assets and would be significantly dependent on foreign government-controlled carriers, could not fill the void. Reeve Rept. pp. 27-29. Such a result would not only pose a serious threat to national security, but it would also contravene the explicit purpose of the Shipping Act "to enwuraee the development of an economically sound and efficient United States-flag liner fleet capable of meeting national security needs." Shipping Act §2(3) (emphasis added).

F. Regulatory Issues

APL's 10/10/03 Comments (pp. 5-7) noted the extremely broad and diverse spectrum of non-transportation services that can be included in "supply chain management" contracts. We also noted (pp. 13-14) some of the regulatory and jurisdictional questions that are posed by the UPS, BAX and CHRW petitions, which contemplate that supply chain management services would be included in service contracts that would be subject to the normal Shipping Act requirements governing service contracts.[21] For example, would the Commission have jurisdiction over non-ocean transportation services such as production quality control at a foreign factory; would the statutory obligation to adhere to the terms of filed service contracts extend to such services; would the service contract need to be amended every time a change was made regarding such services; could VOCCs file agreements under sections 4 and 5 of the Act authorizing them to discuss such services; and how could the Commission know the price

---

21/ UPS Petition pp. 2-3 & n.1, 7; BAX Petition p. 5; CHRW Petition p. 8 n.2.

being charged for ocean transportation? We do not have answers to these or similar questions, and do not see how petitioners' proposals could go forward without satisfactory answers.

G. NVO Tariff Filing In General

While the above policy discussion has been framed in terms of the mega-NVOs' proposals to allow them to enter into confidential service contracts with shippers, the same policy issues and concerns are raised by NCBFAA's proposal to completely abolish the tariff filing requirement for all NVOs. Because NCBFAA's proposal would also allow NVOs, without any investment in maritime transportation assets, to enter into confidential contracts with shippers, it would also create the same risks for competition, for the structure of the VOCC industry, for adequacy of capacity and maritime in&structure, for rates, for innovation, and for national security. In addition, as explained in APL's 10/10/03 Comments (pp. 19-23), NCBFAA's proposal would put at serious risk the congressional scheme for protecting the public from unscrupulous or financially unsound NVOs. (NCBFAA's alternative proposal concerning range rates is discussed at pp. 26-27 below.)

III. THE COMMISSION LACKS LEGAL AUTHORITY TO GRANT THE PETITIONS

We consider the policy issues just discussed the central issue for Commission attention in addressing the petitions before it. There is in addition, of course, the issue of Commission authority.

Addressing the issue of the Commission's authority to grant the privileges sought in the petitions, we established in APL's 10/10/03 Comments (as did the World Shipping Council in its wncurrently filed comments):

- Congress, in enacting OSRA, made a considered and explicit decision to continue and expand the authority of vessel operating wmmon carriers to enter into confidential service contracts with shippers, and to deny that authority to NVOCCs. The principal stated basis for the Congressional decision to so distinguish between VOCCs and NVOCCs was that VOCCs have made an investment in maritime assets while NVOCCs -- by definition -- have not, and that permitting NVOCCs the use of service contracts with shippers is in result not only unfair but would also act as a disincentive to the ownership and operation of ships. An additional stated wncern was that, because only large NVOCCs were likely to be able to take advantage of service contracts, small NVOCCs would be prejudiced in competing with large NVOCCs;
- In enacting OSRA, Congress, while simplifying tariff procedures, made a considered and explicit decision to retain the requirement of tariff publication by NVOCCs -- and by VOCCs to the extent that VOCCs do not provide service pursuant to a service contract -- and to retain the extensive regulatory structure grounded in tariffs. It did so with a clear understanding that NVOCCs objected to the tariff publication requirement, which they claimed to be burdensome and to serve no useful purpose;

- The Commission's exemption authority, permitting the Commission to exempt "any specified activity * * * from any requirement of this Act," in terms precludes a Commission use of the exemption authority to redefine the statutory term "service contract" to include NVOCCs as well as VOCCs;
- More generally, the Commission lacks authority, under the statutory exemption provision or otherwise, to effect the fundamental changes being sought by the NVOCCs to the 1984 Act regulatory regime. This is highlighted by the fact that the very changes being sought by the NVOCCs were considered, and explicitly rejected by the Congress in the recent OSRA amendments to the 1984 Act.

As evidenced by the NVOCC comments tiled to date, the NVOCCs are seriously divided on the extent of the Commission's authority to grant the NVOCCs' requests. For example, Menlo Worldwide Forwarding, which filed comments concurrently with APL, appears to take the position that the Commission has full power to grant <u>all</u> of the authorities being sought by the NVOCCs -- both for NVOCCs to enter into service contracts and the elimination of NVOCC tariff publication. OWL, at the other extreme, recognizes that the Commission might "not rule favorably on either or both petitions on the grounds that its statutory exemption authority does not extend to matters which Congress has addressed directly * * *." [9/8/03 Petition, p. 2] (proposing an alternative, but no less comprehensive change in the 1984 Act regulatory scheme). BAX, acknowledging that the Commission's exemption power does not authorize Commission action that would conflict with the "overall regulatory scheme created by Congress" [1013 1/03 Letter, p. 4],[22] and that a blanket exemption for all NVOCCs would have that effect *[id.* at 8], argues that g-ranting service contract authority to "qualified NVOCCs" is within the Commission's authority. This appears to be the position of C. H. Robinson as well. The NCBFAA, in contrast, argues that "[m]aking the requested exemption [to enter into service contracts] available to only some NVOCCs * * * would be problematical under Section 16 * * *." [10/10/03 Comments, n.3] The NCBFAA, in its initial filing, sought to exempt NVOCCs from all provisions of the 1984 Act relating to the publication and adherence to rate tariffs, but recognizing that the Commission could find that "it is without authority to issue an exemption of this nature" [8/8/03 Petition, p. 4] urged on the Commission the fallback position of a more limited exemption for range rates.

It is hardly surprising that the NVOCCs are having such difficulty formulating a common position on the scope of the Commission's authority because, as we demonstrated in our 10/10/03 Comments, the NVOCC proposals (limited range rates possibly excepted[23])

---

[22] The BAX comments are contained in a letter dated October 3 1, 2003, addressed to Commissioner Anderson. Although the letter does not appear on the docket lists for any of the petitions, we assume that it is or will be part of the official record, since the letter references Petitions P3-03, P5-03, P7-03 and P9-03 and copies were sent to each of the Commissioners and the FMC's General Counsel.

[23] In APL's 10/10/03 Comments, we noted a possible exception with respect to NCBFAA's alternative proposal for range rates. Because the NCBFAA proposal was extremely brief and entirely conceptual, it was not possible to comment further. Since then, the NVOCC-Government Affairs Conference and New York/New Jersey Foreign Freight Forwarders and Brokers Association (Government Affairs Committee) have filed joint comments [12/19/03] offering a proposal for what range rates might look like. Since the NVOCCs acknowledge that any range rate proposal would require a further FMC rulemaking proceeding, we comment only briefly here. First, the range proposed is huge -- the maximum can be up to twice the minimum. Grant of any such proposal would effectively do away with tariffs, and hence is not only outside

(continued...)

would have the Commission take action that exceeds that authority. In APL's 10/10/03 Comments, we provided detailed support for our position and responded to the petitioners' arguments seeking to support Commission authority to grant the particular requests being proposed in the petitions. Here we respond to new arguments addressed to the Commission's authority advanced in the comments filed wncurrently with or subsequent to our 1 O/l 0/03 comments.

1. Legislative History. BAX, along with UPS and CHRW, would have the Commission believe that Congress, while rejecting a universal right to service contracting by NVOCCs, did not intend to withhold that right from large, financially stable NVOCCs. The fundamental and insurmountable hurdle to this approach, of course, is the statutory language, *i.e.*, the definition of "service contract" in Section 3(19) of the 1984 Act, which makes no distinction whatever between NVOCCs of any nature -- all are excluded from the definition. BAX largely ignores the statutory language and attempts to support its position from the legislative history arguing, essentially, that all the relevant legislative history that undercuts BAX's position must be ignored.

23/ (...continued)
of the Commission's authority, but also implicates all of the issues raised by a total elimination of tariffs. Second, the Government Affairs Committee argues -- wntrary to the NCBFAA petition -- that the Commission could adopt a range rate proposal without resort to its exemption authority, by using its power to issue regulations implementing tariff publication. That position is highly questionable. See *Southwestern Bell Cop v. FCC, 43* F.3d 1515 (D.C. Cir. 1995), where the D.C. Circuit held that the FCC could not use its authority to issue regulations in order to allow carriers to file range rates in their tariffs, as opposed to the actual charges that customers would pay.

As we identified in APL's 10/10/03 Comments, the issue of whether or not NVOCCs would be granted the right to enter into service wntracts with shippers was the central -- indeed the exclusive -- issue debated when the OSRA legislation came before the Senate. Senator Gorton proposed a very narrow amendment to the bill under consideration, the sole purpose of which was to grant NVOCCs that right -- by omitting the word "ocean" from the reference "ocean wmmon carrier" in the definition of service contract. The Gorton amendment was resoundingly defeated (as was an equivalent position defeated in the House). BAX argues that this significant event in the legislative development of OSRA -- identifying an unqualified rejection of NVOCC service wntract authority -- should be ignored on grounds that "it is particularly improper to consider legislative history pertaining to proposed amendments to bills." [1013 1/03 Letter, p. 6] While there are undoubtedly contexts where the rejection of a proposed amendment would have neutral significance, this could not be the circumstance here given the limited and focused nature of the Gorton amendment. The relevant case law so establishes.[24] And the author of the 1983 Law Journal article on which

---

[24] The Supreme Court itself regularly considers the rejection of proposed amendments when it is construing statutes. For two recent examples, see Crosby v. *National Foreign Trade Council, 530* U.S. *363,378* n.13 *(2000); Williams v. Taylor, 529* U.S. 362,378 n.10 (2000). See also, *e.g., United States v. McNab,* 331 F.3d 1229, 1238 (1 1th Cir. 2003) (among the things that a court examines "[i]n trying to learn Congressional intent" is "'the effect of amendments whether accepted or rejected"' (quoting from *Rogers v. Frito-Lay, Inc.,* 611 F.2d 1074, 1080 (5th Cir. 1980); *Bedroc Ltd., L.L.C. v. United States,* 314 F.3d 1080, 1086-88 (9th Cir. 2002) (using amendment rejection in construing enactment), *cert. granted, 124 S. Ct. 45 (Sept.* 30, 2003). As the leading commentary on statutory construction states: "Generally the rejection of an amendment indicates that the legislature does not intend the bill to include the provisions embodied in *the* rejected *amendment."* 2A *Singer, Sutherland Statutes & Statutory Construction* § 48.18 (2000). Moreover, the Commission itself has recognized the force of Congress' rejection of the Gorton amendment. In Docket 98-30, the Commission responded as follows to a comment

(continued...)

BAX solely relies himself identifies that the author's personal view expressed in the article is not necessarily consistent with judicial precedent.[25]

BAX acknowledges "[t]he comments of Senators Breaux and Hutchinson, Representative Oberstor and others, suggesting that only vessel operators should enjoy service wntract authority because vessel operating carriers 'have invested millions of dollars in the vessel and pay for its operating costs * * *.'" [10/31/03 Letter, p. 6] It goes on to assert (indeed, on the very same page of its filing) that there is "nothing in [the OSRA legislative] history that would prohibit the limited application of service contract authority to well-qualified, financially sound" NVOCCs. Were these two sentences written by the same person? Or is BAX following the struthious school of advocacy -- to ignore relevant authority that does not support its position? The statements on the floor of the Senate and House, referenced by BAX in the first of the sentences quoted above, as we identified in APL's 10/10/03 filing, were advanced as the governing reason why VOCCs should be granted the right to enter into service contracts and why the Gorton amendment, which would have extended that right to NVOCCs, should be rejected. Given the critical emphasis during the enactment of OSRA on vessel assets and vessel operations as the factors governing the

---

24/ (...continued)
that it should allow NVOCCs to offer confidential service contracts to shippers: "This was explicitly rejected by Congress when it rejected the Gorton Amendment (No. 2287) to S. 414, which would have so allowed." 64 Fed. Reg. 11186, 11190 n.3 (March 8, 1990).

25/ Indeed, the author prefaced his remarks about congressional action rejecting or accepting proposed amendments with the statement that it is "often relied on by courts in interpreting or applying statutes." R. Dickerson, "Statutory Interpretation: Dipping Into Legislative History," 11 Hofstra L. Rev. 1125, 1133 (1983).

availability of service contracts, BAX's arguments that the legislative history does not negate a grant of service contracting authority to some subset of NVOCCs -- which also does not own or operate vessels -- is simply not credible.

Moreover, the context of the congressional debate shows that Congress did effectively consider and reject grant of contracting authority to a subset of NVOCCs such as BAX proposes. As we demonstrated in our original comments, and summarized above, opponents of the Gorton amendment identified their understanding and concern that contracting authority would in fact be used only by a small class of large NVOCCs. See, e.g., 144 Cong. Rec. S3200 (Apr. 3, 1988) (Sen. Breaux); *id.* at S3307 (Apr. 21, 1998). Given that understanding, the rejection of the Gorton amendment must obviously be taken equally as a rejection of granting authority solely to that very same class of NVOCCs.

2. Exemption Authority. None of the petitions rigorously addressed the scope of the Commission's Section 16 exemption authority as applied to the fundamental nature of the regulatory changes proposed in the petitions. The petitioners claimed, and attempted a perfunctory demonstration,. that their requests met the Section 16 criteria relating to competition and detriment to commerce -- a claim, as we have explained earlier in these Further Comments, that is very much in dispute. However, the petitions did not address prior Commission precedent explaining the limited scope of its authority under Section 16[26] or even

---

[26] *See Motor Vehicle Manufacturers Association -Application For Exemption, 25 SRR 849,852* (FMC 1990); *Petition of COSCO For a Limited Exemption, 28 SRR* 144,148 & n.10 (FMC 1998); *Motor Vehicle Manufacturers Association & Wallenius Lines, N.A. --Joint Application For Exemption,* 26 SRR 1269, 1277-78 (ID, Adopted 1994). The limited nature of the Commission's authority has also been emphasized by the Supreme *Court. Volkswagenwerk*
(continued...)

identify the two post OSRA Commission pronouncements acknowledging the Commission's lack of authority to extend service contract authority to NVOCCs.[27]

While OSRA amended Section 16 to broaden the Commission's exemption authority by eliminating two of the tests an applicant is required to meet to be afforded an exemption, it did not purport to reject the Commission's longstanding interpretation of the nature of its authority or to grant the Commission authority, through the exemption power, to fundamentally reverse the Congressionally established regulatory regime for ocean shipping. Rather, as the Senate Committee report addressed to OSRA explains, the Commission under Section 16 was admonished to focus on "specific regulatory provisions and practices not yet addressed by *Congress* to determine where they can be deregulated consistent with the policies of Congress." [S. Rep. No. 105 61, 105th Cong., 1st Sess. 30 (July 31, 1997)]

Congressional policy on the two issues principally addressed in the petitions - NVOCC service contracting and NVOCC tariff filing -- was recently and emphatically reaffirmed by

---

26/ (...continued)
Aktiengesellschaft v. *FMC*, *390* U.S. 261, 276-77 (1968) (FMC's exemption authority restricted to "de minimis" or routine agreements).

27/ Federal Maritime Commission, *The Impact of the Ocean Shipping Reform Act of 1998* at 49 (Sept. 2001) ("whether to confer upon NVOCCs the right to enter into service contracts in their carrier capacities is peculiarly a legislative prerogative and is not a matter subject to administrative discretion"); Docket 99-10, 65 Fed. Reg. 26506, 26512 (May 8, 2000) ("Congress recently and very consciously chose not to permit such activity when it enacted OSRA. The Commission will not now do what Congress declined to do."). Likewise, in Docket 98-30, the FMC's response to a commenter's request that NVOCCs be authorized by rule to offer confidential service contracts to their shippers was simple and direct: 'This was explicitly rejected by Congress when it rejected the Gorton Amendment." 64 Fed. Reg. 11186, 11190 n.3 (March 8, 1990).

Congress by virtue of the enactment of OSRA. Beyond that, the Commission has recognized in prior decisions that Section 16 does not confer authority to repeal or substantially amend the fundamental regulatory scheme of the 1984 Act[28] -- a position, we might add, that at least one of the petitioners has explicitly acknowledged. [BAX, 1013 1/03 Letter, pp. 4 & 5]

In its October 10 Comments, Menlo Worldwide rejects this approach, arguing that "'the Commission's authority to grant prospective exemptions with regard to ocean freight pricing is unfettered either by the text or the legislative history" of Section 16. [10/10, p. 8] Menlo's statement that the Commission's authority "is unfettered by * * * the text" of Section 16 is confusing because the substance of Menlo's argument is that the Commission may <u>only</u> look to

---

[28] In *Motor Vehicle Manufacturers Association --Application For Exemption, 25 SRR 849,* 852 (FMC 1990), for example, the Commission stated:

> "The 1984 Act prescribes a specific statutory scheme which the Commission has been charged with enforcing. Section 16 of that Act does not provide authority to repeal or substantially amend that regulatory scheme." (Footnote omitted).

Although the particular context of this statement was in a discussion of the impairment of regulation criterion that was deleted by OSRA, there was nothing in OSRA that was intended to reverse this as a basic principle, as is evident both from the Senate Report discussed in the text above, and from the Commission's own post-OSRA responses to prior requests for NVOCC contracting authority discussed at n.27, above.

As we addressed at some length in our original submission, the effect of formally or effectively eliminating the requirement to publish tariffs (just as extending the right to NVOCCs to enter into service contracts with shippers) would gut the regulatory scheme of the Act as currently mandated by Congress, including the provisions for licensing and bonding of NVOCCs. Moreover, the effect would be to entirely deregulate international ocean transportation -- for VOCCs as well as NVOCCs -- to the extent that the regulatory regime is grounded in tariffs or service contracts. VOCCs would no longer have any reason to use service contracts, since they could obtain more flexibility and fewer restrictions simply by entering into non-tariff arrangements, either directly, or through an affiliated NVOCC.

the text of Section 16 to determine the scope of its authority [pp. 8, *et seq.*],[29] *thus* ignoring the Commission's (and the Supreme Court's) own prior construction of Section 16 and the legislative history of the OSRA amendments.

None of the cases cited by Menlo for this novel position support it. *Chevron*[30] does not stand for the "plain meaning" standard Menlo asserts. To the contrary, the Court there examined the legislative history as part of its effort to ascertain whether the agency's interpretation of the statute was sustainable. What Chevron stands for is that where the intention of Congress is clear -- from whatever source, whether the statute itself or the legislative history -- neither the agency nor the court is free to ignore the unambiguously expressed intent of Congress. If, however, Congress has not addressed the precise question, then the test is whether the agency has adopted a permissible construction.

Nor does *American Trucking*,[31] as Menlo claims, stand for the proposition that an agency's exemption authority is measured by the literal language of the act despite legislative history to the contrary. Rather, it stands for the proposition that where it was unclear whether or not a particular type of item was included within an agency's mandate, in the absence of any expression of Congressional intent either in the rest of the statute or the legislative history, the agency's interpretation would be upheld based on the literal language of the statute.

---

[29] As we have identified, the text of Section 16 permits the Commission to exempt carriers from a "requirement" of the Act but does not authorize the Commission to amend the statutory definition of "service contract."

[30] *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467* U.S. 837 (1984).

[31] *American Trucking Association Inc. v. ICC, 656* F.2d 1115 (5th Cir. 1981).

In sum: (a) if one were to employ Menlo's proposed 'plain meaning" approach to the Commission's exemption authority, it would prohibit the use of Section 16 to redefine the statutory definition of service contract, while (b) that same result flows from a more appropriate analysis of Section 16, taking into account the Commission's prior construction of that provision and the clearly stated legislative intent addressed to that provision during enactment of OSRA.

3. <u>Changed Circumstance.</u> A consistent mantra throughout the filings of the petitioners is that changed circumstances since the enactment of OSRA permit the Commission to reverse the policy decisions consciously adopted by Congress prohibiting NVOCC service contracting and requiring NVOCC tariff publication. It is, however, by no means clear that the changes that petitioners identify and rely upon are either as fundamental as they claim or were not well within the contemplation of Congress when it enacted OSRA. Petitioners, for example, identify the significant shift by VOCCs to the use of service contracts since OSRA. However, that shift lies at the heart of OSRA,[32/] and to attempt to justify a fundamental restructuring of the statute on the ground that OSRA is achieving one of its intended

---

[32/] The Senate Report on S. 414, for example, states in the "Summary of Major Provisions" that it would:

> "1. Provide shippers and common carriers greater choice and flexibility in entering into contractual relationships with shippers for ocean transportation and intermodal services. The most significant improvement is the right of members of ocean carrier agreements to negotiate and enter into service contracts with one or more shippers independent of the agreement." S. Rep. No. 105-61, 105th Cong., 1st Sess. 5-6 (July 31, 1997).

Congressional objectives would turn rational regulation on its head. Petitioners imply that Congress may have been unaware of the possible entry into the logistics market of large, financially stable NVOCCs and that had Congress been so aware, it would have authorized the use by such NVOCCs of service contracts. See, e.g., UPS Petition, pp. 8 9, 21 23, C. H. Robinson Petition, pp. 6 7, 20 22. However, there are a number of references to such mega-NVOCCs in the debate over the Gorton amendment. See, e.g., 144 Cong. Rec. S3200 (Apr. 3, 1998) (Sen. Breaux); *id.* at S3307 (Apr. 21, 1998). While those mega-NVOCCs were identified as primarily foreign based, there is not the slightest suggestion that Congress would have been more congenial to grant them service contract rights had they been mostly U.S. based.

Another recurring theme in petitioners' tilings is that, subsequent to OSRA, U.S. carriers have been acquired by foreign owners. While it is correct that the major U.S.-flag foreign trade carriers are now foreign owned, those carriers continue to operate U.S.-flag vessels with U.S. crews and are the heart of tbe Maritime Security Program, of the Department of Defense's VISA program, and represent vital national assets. See pp. 19-22 above. To suggest, as petitioners appear to, that these U.S. flag carriers no longer count, so that new policies that prejudice them would meet with Congressional approval, is not only factually wrong and inconsistent with Congress' recent reauthorization of the MSP program, but also seeks to have the Commission ignore the declared policy of the 1984 Act "to encourage the development of an economically sound and efficient United States-flag liner fleet capable of meeting national security needs * * *." [§ 2(3)]

However one views or characterizes the changes to which petitioners make reference, petitioners appear to be of the view that those changes afford the Commission broad discretion to grant the requested relief and in so doing to fimdamentally restructure the 1984 Act. We have identified above that the Commission's exemption authority under Section 16 cannot reasonably be interpreted to authorize that result. And while BAX claims that the Supreme Court has sanctioned agency action under a statute in contradiction of Congressional intent if grounded in dramatically changed circumstances, the cases simply do not substantiate BAX's claim. For example, BAX argues that the Supreme Court *Pattern Maker's* case[33/] stands for the proposition that an agency can take action contrary to the legislative history where circumstances have changed. It does not. There is nothing in the discussion cited about changed circumstances; nor did the Court conclude that the agency's action was contrary to the legislative history. Rather, the petitioners in that case argued that the agency's action was contrary to a clear legislative policy decision, as reflected in the legislative history, and the Court rejected that argument on the grounds that the legislative history was too ambiguous and inconclusive to show that the agency's interpretation was unreasonable. BAX likewise misstates what the court did *in the Trans-Pacific Freight Conference* case.[34/] As determined by the court there, the legislative history did not, as BAX says, contemplate that the FMC would address the self-policing practices of the conferences on an *ad* hoc basis, rather than by rule. That was what the *opponents* of the rule argued. Rather, the court concluded that Congress had

---

[33/] *Pattern Maker's League of North America, AFL-CIO v. NLRB, 473* U.S. 95 (1985).

[34/] *Trans-Pacific Freight Conference of Japan/Korea v. FMC, 6.50* F.2d 1235 (D.C. Cir. 1980).

not expressed a view on the matter, but had left it up to the FMC to decide, whether and/or when to proceed by rule, rather than *ad hoc* decisionmaking.

Contrary to the position that petitioners urge on the Commission, the case law is clear that changes *in an* industry environment does not vest *an* agency *carte blanche* to rewrite a statute and ignore the regulatory structure established in that statute by the Congress. As the D.C. Circuit has explained, if a Commission believes that there is no longer any need for a statutory tariff scheme "in light of changed circumstances," the appropriate course is for the Commission to make appropriate recommendations to Congress. "The Commission may not, instead, ignore congressional directives because it believes 'traditional tariff regulation' is 'unnecessary' and 'counterproductive."' *Southwestern Bell Corp. v. FCC, 43* F.3d 1515, 1519 (D.C. Cir. 1995). To like effect is *MCI Telecommunications Corp. v. AT&T Co.,* 512 U.S. 2 18,234 (1994), where the Court stated that the FCC's views on desirable policy due to the end of the AT&T monopoly could not be used to "alter the meaning"of the Act, and that "the Commission's desire 'to "increase competition" cannot provide [it] authority to alter the well-established statutory filed rate requirements'." (Quoting *in* part from *Maislin Industries, U.S., Inc. v. Primary Steel, Inc.,* 497 U.S. 116, 135 (1990)). And as the Court also explained in *Maislin*, although an agency may "generally" adopt new policies in light of new developments in the industry, "it does **not** have the power to adopt a policy that directly conflicts with its governing statute." 497 U.S. at 1434-1435 (emphasis added).

IV. CONCLUSION

The issues raised by the petitions are important and complex. AF'L has devoted significant resources to understanding and analyzing the potential implications of the regulatory changes being proposed to the Commission. In addition to relying on its own substantial in-house capability, APL has engaged a noted management and economic consulting firm with extensive experience in maritime transportation -- Reeve & Associates -- to conduct an independent evaluation of petitioners' proposals. That evaluation is presented in the report submitted with these Further Comments.

We do not pretend that we have all the answers. Nor do we have access to many of the facts on which the answers to the issues raised in the petitions will significantly depend. More importantly, at this point neither does the Commission.

That said, based on the information currently available to us, there is a reasonable basis to believe that the grant of either of the two proposals advanced in the petitions -- the extension of service contracting rights to NVOCCs, whether it be the industry as a whole or a subset comprising the largest, financially sound members of that industry, or the elimination of NVOCC tariff publication -- could have profound and potentially adverse effects for international ocean shipping, and could result in a fundamental restructuring of the industry. Unless the Commission were to completely disagree with that evaluation -- and on the record before it, we do not believe that the Commission could rationally arrive at such a position -- the issues deserve, indeed require, a thorough inquiry by the Commission. As we explained in our 10/10/03 Comments [pp. 3-4, 27], this is true regardless of the legal barrier to the Commission's ability to favorably act on the petitions, because a thorough evaluation of the issues will inform the Congress if the petitioners, as appears likely, ultimately take their case to Capitol Hill.

It is a regular practice for a regulatory agency to use its investigative powers not only to consider whether to take action itself, but also to develop recommendations for possible revision of the agency's statutory **authority,**[35] as the Commission has previously identified in the context of its own statutory mandate.= The Commission should do so in acting on the pending petitions given their major implications to the industry, to the Commission's regulatory authority and, potentially, in Congress.

The issues that lie at the heart of the petitions are grounded both in fact and policy. The Commission must develop the facts as to the various interested parties' operations and competitive postures in order to be in a position to evaluate the implications of the proposals and determine, as a matter of policy, what is most appropriate for the various participants in the industry, their customers and the national interest. It can only achieve those objectives through the use -- or at least the availability -- of compulsory process.

---

[35] As explained in a leading treatise on administrative law: "Agencies now conduct investigations to make rules, to determine policy, to recommend legislation, and to illuminate areas in order to **find** out whether something should be done and if so what." Pierce, *Administrative Law Treatise* **§ 4.1** at *195 (4" **ed.**). See, e.g.,* ***Deering-Milliken,*** *Inc. v. FTC, 595* **F.2d** 685,702 (D.C. Cir. 1978) ("the investigative power of the Commission may be used to reveal the need for changes in the law for purposes of making recommendations to Congress") (citing *FTC v. Texaco, Inc., 555* **F.2d** *862, 875* n.28 (D.C. Cir. 1977); *United States Department* ***of Labor*** *v. Kast Metals* Corp., 744 **F.2d 1145, 1150** (5" Cir. 1984) ("Agencies may of course investigate for a variety of [non-adjudicatory] purposes, such as . . . reporting to Congress").

[36] 55 Fed. Reg. 34610 (Aug. 23, 1990) (commencing Fact Finding Investigation No. 19 regarding the cruise industry and explaining that the investigation was designed "to establish a sound basis for review of current FMC regulations" concerning that industry, and to "consider possible legislative improvements . . which the Commission might propose to the Congress").

We thus urge the Commission: to initiate an investigation into the issues raised by the petitions and to appoint an investigative officer with authority to develop the relevant facts using both voluntary and compulsory process; to the maximum extent possible, consistent with the preservation of truly business sensitive information, to make tbe information so developed available to all interested parties; and to provide an opportunity to comment on the factual conclusions, analysis and recommendations emerging from the investigation before their final adoption. These procedures will afford all interested parties the opportunity of providing meaningful input into what gives every evidence of representing a fundamental cross-roads for competition in the international ocean trades and the regulatory structure to be applied to that competition.

APL's objective is not to defend old ways of doing business. The logistics business is important, and APL's sister company, APL Logistics, is a significant player in that business. It is also true, however, that only five years ago the Congress adopted major changes to the regulatory environment governing ocean shipping, and those changes have transformed -- beneficially for all -- the way that the ocean transportation business is now being conducted. Those benefits, and the further improvements and refinements that inevitably will be achieved as experience deepens, should not be prejudiced without a full understanding of the implications. The procedures we have suggested are designed to provide the Commission, and potentially the Congress, the grounds for such an understanding.

Respectfully submitted,

Robert T. Basseches
David B. Cook
Eric C. Jeffrey
SHEA & GARDNER
1800 Massachusetts Ave., N.W.
Washington, D.C. 20036
(202) 828-2000
Attorneys for American President Lines, Ltd.
and APL Co. Pte.. Ltd.

January 16, 2004

CERTIFICATE OF FILING

I certify that on January 16, 2004, I filed the Further Comments of American President Lines, Ltd. and APL Co. Pte., Ltd. in Reply to the Petitions in Dockets P3-03, P5-03, P7-03, P8-03 and P9-03, by causing a copy to be mailed, first class on this date, and an original and 15 copies to be hand delivered on the morning of the next business day, January 20, 2004 to:

Hon. Bryant L. VanBrakle
Secretary
Federal Maritime Commission
800 North Capitol Street, Room 1046
Washington, D.C. 20573-0001

COURTESY COPIES BY FIRST CLASS MAIL

J. Michael Cavanaugh, Esq.
Holland & Knight LLP
2099 Pennsylvania Avenue, N.W.
Suite 100
Washington, D.C. 20006-6801

Charles L. Coleman, III, Esq.
Holland & Knight LLP
50 California Street
Suite 2800
San Francisco, CA 94111

Edward D. Greenberg, Esq.
David K. Monroe, Esq.
Galland Kharasch Greenberg Fellman & Swirsky, P.C.
1054 Thirty-First Street, N.W.
Washington, D.C. 20037-4492

Leonard L. Fleisig, Esq.
Troutman Sanders LLP
401 Ninth Street, N.W., Suite 1000
Washington, D.C. 20004

Edward J. Sheppard, Esq.
Thompson Cobum LLP
1909 K Street, N.W., Suite 600
Washington, D.C. 20006

Carlos Rodriguez, Esq.
Rodriguez O'Donnell Ross Fuerst Gonzalez & Williams
1211 Connecticut Ave., N.W., Suite 800
Washington, D.C. 20036

Eric C. Jeffrey

APPENDIX

REEVE & ASSOCIATES REPORT

Reeve & Associates

Management and Economic Counsel

Important Questions Raised by Petitions to the Federal Maritime Commission Concerning Non Vessel Operating Common Carriers and Service Contracts

January 16, 2004

Contents

I. Introduction

American President Lines, Ltd. and APL Co. Pte. Ltd. retained Reeve &Associates to develop an independent evaluation of facts associated with the several petitions before the Federal Maritime Commission (FMC) concerning requests for permission by Non Vessel Operating Common Carriers (NVOCC's) to enter into confidential service contracts with their shipper customers,' and to identify more fully the important policy questions for the FMC that arc raised by these petitions. Our analysis has been based entirely on publicly available data sources and our own understanding of the international ocean transportation industry and commerce. In particular, our analysis has focused on the implications for the United States of the several petitions in terms of their potential impact upon international commerce, the provision of essential ocean transportation services, and national security.

The issues addressed in this report fall into the following major areas:

- Potential significant changes to the competitive balance in liner shipping caused by the increased ability of large NVOCC's ("mega-NVOCC's") to aggregate buying power for ocean shipping services if permitted to enter into confidential service contracts directly with beneficial cargo owners

- Potential effects on vessel operating common carriers (VOCC's) and shippers involved in international trade caused by the possible disconnection of the direct sales and marketing relationship between those parties due to increased market power of mega-NVOCC's

- Potential effects from reduced future investment by carriers in shipping capacity and maritime transportation infrastructure due to depression of their earnings resulting

---

[1] Petition No. P3-03: Petition of United Parcel Service, Inc. for Exemption Pursuant to Section 16 of the Shipping Act to permit Negotiation, Entry, and performance of Service Contracts;
Petition No. P5-03: Petition of National Customs Brokers and Forwarders Association of America, Inc. for a Limited Exemption from Certain Tariff Requirements of the Shipping Act:
Petition No. P7-83: Petition of Ocean World Lines, Inc. for a Rulemaking to Amend and Expand the Scope of "Service Contracts":
Petition No. P8-03: Petition of BAX Global, Inc. for Rulemaking;
Petition No. P9-03: Petition of C.H. Robinson Worldwide, Inc. for Exemption Pursuant to Section 16 of the Shipping Act to Permit Negotiation, Entry, and Performance of Confidential Service Contract

from the increased market power of mega-NVOCC's and the consequent impact on ocean freight rate levels and service

- Potential deterioration in the quality of ocean transportation services if carrier margins are reduced and direct ocean carrier-shipper contacts are undercut by the increased market power of mega-NVOCC's

- Potential effects of reduced ocean carrier earnings on innovation in the shipping industry due to the increased market power of mega-NVOCC's

- Potential impact on U.S. national security if reduced carrier earnings and increased risk caused by increased mega-NVOCC market power makes carriers reluctant to undertake the costs and risk of U.S. flag vessel operation

- Potential effects of the elimination of ocean freight tariff publishing

Given the short time available and the present status of the proceedings, our findings at this time are not fully conclusive. However, based on our initial analysis of the petitions and their potential for significant impact on competitive conditions in ocean shipping and the supply of shipping services that provide essential support for international trade and commerce, this initial assessment clearly demonstrates serious cause for concern and therefore the need for a more detailed and comprehensive analysis of the several important questions raised as they relate to petitioners' various proposed changes to current U.S. government policy regarding NVOCC's.

Background on Reeve & Associates

Reeve & Associates is a management consulting firm that specializes in the fields of international trade, transportation, and logistics. We have advised organizations in both the public and private sectors on strategy development, mergers and acquisitions, market and economic analysis, organizational and operational performance improvement, and the development of public policy involving international transportation and logistics. Our clients include many of the leading shipping companies in the United States and around the world as well as port authorities, marine terminal operators, shippers, and government organizations.

The resume of John G. Reeve, President of Reeve & Associates and principal author of this report, is attached as an appendix to this report.

II. Effects on Ocean Carriers and the Structure of the Industry

Global Logistics Service Developments

Container shipping has been a major contributor to global economic growth since the 1960's as an important facilitator of international trade and commerce. Over the last ten years, while the global economy has grown at an average annual rate of 2.7 percent in real terms, the volume of global containerized trade has increased by 8.6 percent per year? The rapid expansion of containerized trade has been driven not only by the major reduction in transportation cost afforded by containerization, but also by a quantum leap in the efficiency of moving goods faster, more reliably, and with less damage. Containerization has also played an important role in more tightly integrating the multiple steps in shippers' international supply chains by linking previously separate land and ocean transportation movements into a single "intermodal" cargo movement.

Recently, supply chain integration has moved beyond the scope of the container as transportation and logistics service providers have used the power of advanced computerized cargo-tracking tools and global telecommunications systems to monitor and control the movement of cargo literally from its initial factory floor origin to final destination thousands of miles away. A competitive edge in supply chain management capabilities has become a critical strategic element in the business models of such companies as Dell Computer, Wal-Mart, and Amazon.com, contributing to superior business performance by enabling them to move goods to their customers faster and more cheaply while reducing the cost of holding inventory.

In order to assist shippers in achieving a level of excellence in supply chain management, a number of companies with transportation and logistics backgrounds have repositioned themselves as international logistics services experts, offering their services to shippers as "managers" of the shipper's global supply chain on an "outsourced" basis. By definition, the role of such a supply chain manager requires a one to one relationship with the

[2] Global Insight for economic data; H.P. Drewry Container Market Review- 200304 for container traffic data.

shipper. While a shipper may choose to deal with multiple transportation service providers, there can only be one manager of a particular supply chain. The supply chain manager may or may not provide transportation assets and services in actually moving the shipper's goods. Some may focus their expertise entirely on managing other parties involved in the various stages and elements of the shippers' supply chain while others may contribute some of their own assets or services to meeting the shippers' needs while also integrating those with services provided by other third parties.

Supply chain management expertise does not have to be outsourced. Many successful shippers, such as Wal-Mart, see it as a critical strategic tool that they wish to retain in-house. However, given the significant investment and resources required to build and maintain advanced logistics information systems, in-depth supply chain knowledge and expertise, and global service scope, developing large scale in such a logistics service operation can be essential to its successful performance. Consequently, many small to medium, and even relatively large shippers have opted to outsource their need for supply chain management capabilities to third party logistics service providers.

Of necessity, the providers of a broad portfolio of supply chain management capabilities with global service coverage require significant scale themselves. They must develop and operate logistics management systems that are able to track millions of cargo lots around the world on a global basis, twenty-four hours a day, seven days a week. They must have the resources and people to manage their own and other transportation and logistics service providers in operations around the globe. And, if selling to their customers a "bundled" transportation and logistics service product, they are likely to seek to leverage their ability to purchase transportation and logistics services in large quantities in order to drive down the price they pay to other parties for such services.

Contracts for Ocean Transportation Services

Under the Shipping Act, confidentiality of service contracts for ocean transportation has been reserved for Vessel Operating Common Carriers (VOCC's). These companies provide essentially all of the physical assets required for the international movement of goods by ocean liner service (most notably ships, containers, and marine terminals). On the other hand, NVOCC's, as ocean transportation intermediaries that do not provide such maritime transportation assets but instead purchase transportation services from the ocean carriers (VOCC's) and then resell those services to the NVOCC's shipper customers, are not permitted to enter into confidential service contracts with beneficial cargo owners. However, several of the NVOCC petitions to the FMC request that they be granted the same rights for confidential contracts as currently accorded to the VOCC's.

A key underlying issue at the heart of the several NVOCC petitions to the FMC concerning confidential service contracts is the significant impact on shipping services, international trade, and national security that could occur should NVOCC's be allowed the same rights for confidential service contracts with shippers as currently permitted for VOCC's. Although both VOCC's and NVOCC's sell ocean freight services to shippers, they are very different entities. A VOCC must invest in and operate all of the physical assets required to move freight across the oceans including ships, container equipment, and marine terminals.[3] We estimate that the net investment of the liner shipping industry on a global basis in assets is close to $90 billion, roughly equivalent to the industry's total annual revenue.

As an intermediary, an NVOCC avoids the burden of having to make any significant investment in the physical assets required for ocean shipping; rather the NVOCC buys those services from the VOCC's, marks them up, and resells them to shippers. The NVOCC is fundamentally a sales organization with varied abilities to provide additional services such as the consolidation of multiple shippers' less-than-container-load cargoes into full containers that are then shipped on a VOCC. As mentioned in several of the petitions before the FMC, a number of NVOCC's, particularly those of very large scale that are able to offer shippers a broad portfolio of logistics services across the globe, are now positioning themselves as complete logistics service providers, with the NVOCC role being only a portion of their portfolio of services. A relatively small number of these

[3] For purposes of this discussion, we treat all assets for which a VOCC directly pays for use in its business, either through ownership, lease, or contract as "investments"

"mega-NVOCC's" have already achieved significant market power by aggregating in their hands the purchasing of ocean shipping services in volumes that exceed that of almost all of the largest actual shippers in U.S. trade. By purchasing a broad array of transportation and logistics services in large quantities, these mega-NVOCC's are in the advantageous position to use their strong buying power to drive down the prices they pay for such services from the providers of those services such as the VOCC's. For example, UPS, as an NVOCC moving "approximately 300,000 TEUs of ocean freight annually"[4] after less than three years as a major participant in ocean freight markets,[5] already purchases about the same volume of ocean freight capacity as the largest actual shipper of containerized freight in the United States, Wal-Mart, and 65 percent more freight than the second largest container shipper, Home Depot.[6]

Although statistics on the volumes of ocean transportation into and out of the United States that are purchased by NVOCC's are not readily available, it may be reasonably concluded that several other NVOCC's have similar purchasing power to UPS's as suggested by the following exhibit that compares the revenue earned for transportation and logistics services by a number of mega-NVOCC's that are heavily involved in U.S. international trade. The data is drawn from the financial reports of the respective companies and represents revenues earned on freight (land and air as well as ocean) and other logistics services both within the U.S. and elsewhere around the globe. Such businesses as UPS's package services and DHL/Danzas' package and mail services that are well outside the scope of international ocean freight have been excluded where they could be identified. While the data is only indicative at this point, it does strongly suggest that there are a number of other mega-NVOCC's with purchasing levels similar to UPS's reported 300,000 TEU. In order to develop a deeper understanding of this issue, it will be important to get better information on NVOCC volumes in U.S. trade.

[4] Petition of United Parcel Service, Inc. for Exemption Pursuant to Section 16 of the Shipping Act of 1964 to Permit Negotiation, Entry, and Performance of Service Contracts, July 25, 2003, page 5. Although the petition does not specifically state that UPS's 300,000 TEU are shipped in U.S. trade, we assume that the vast majority of this volume is moved in U.S. trade.

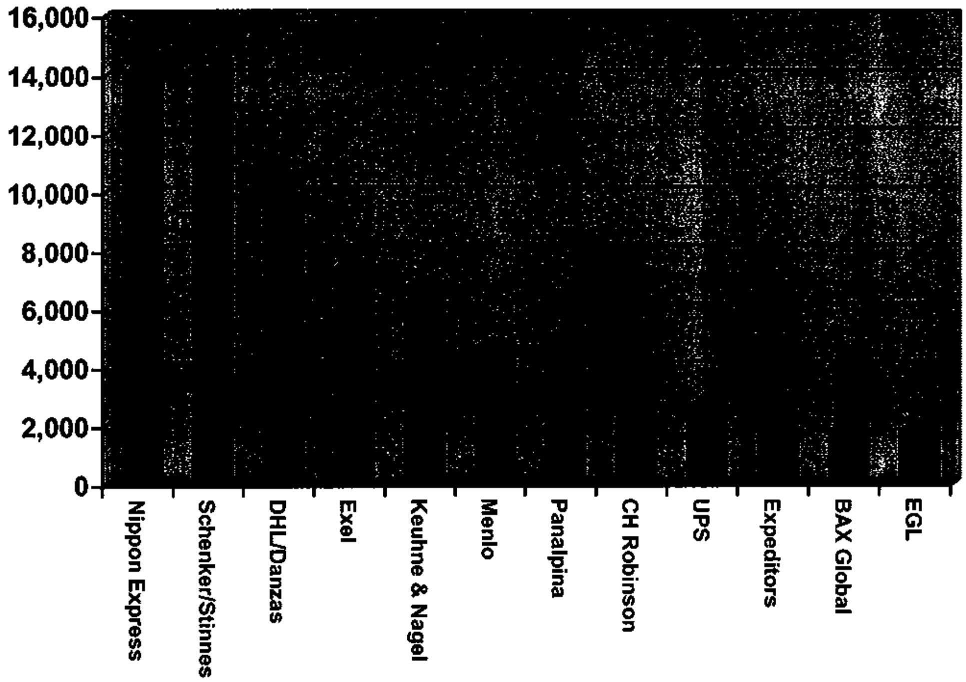
[5] UPS acquired Fritz Companies Inc. in May, 2001.

[6] Journal of Commerce Port Import Export Reporting Service (PIERS), May 4, 2003

Exhibit II-1

Mega-NVOCC Transportation and Logistics Revenues

(millions of dollars in 2002)



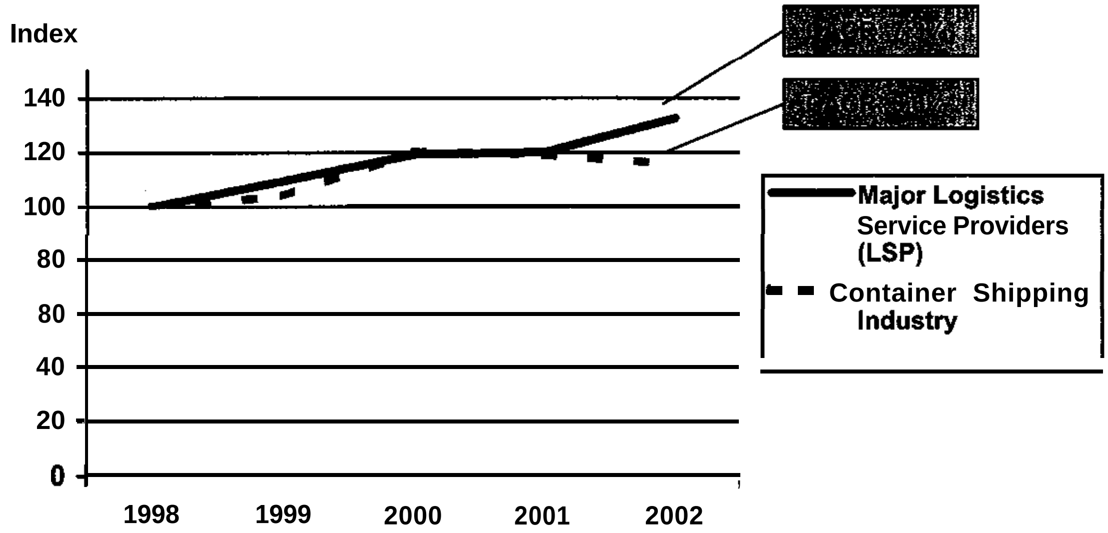
Source: Reeve &Associates analysis of company financial reports

As demonstrated in Exhibit II-2 below, the market power of the mega-NVOCC's appears to have significantly increased in recent years. As shown in Exhibit II-2 below, the revenue earned for transportation and logistics services by the selected twelve mega-NVOCC's[7] has grown twice as fast as the total revenue of the global liner shipping industry over the last five years. The twelve mega-NVOCC's together by 2002 earned close to $73 billion for transportation and logistics services, rapidly closing on the total of $90 billion in revenue estimated for the entire global liner shipping industry from all world trade. The two sets of data are related as the logistics service providers purchase

[7] Excluded from the exhibit data are revenues for other types of services provided by corporate partners of the mega-NVOCC's such as package services and mail delivery. The data for the mega-NVOCC's includes services other than strictly water-related transportation as the financial reports of the respective companies do not allow for such a segmentation.

considerable amounts of ocean transportation as NVOCC's as well as for other services including air and land transportation.

Exhibit II-2
Global Liner Shipping Industry Revenues
versus Selected Major International Logistics Service Providers



Revenue in billions of dollars:

	1998	1999	2000	2001	2002
Major LSP	$55	$60	$66	$66	$73
Container	$77	$80	$93	$92	$89

Sources: Annual financial reports for Major Logistics Service Providers (BAX Global, C. H. Robinson, DHL/Danzas, Eagle Global Logistics, Exel, Expeditors International, Kuehne & Nagel, Menlo Worldwide, Nippon Express, Panalpina, Schenker, and UPS.) H.P. Drewry *Container Market Review- 2003/04* for Liner Shipping Industry.

* CAGR indicates "compound annual growth rate"

As noted above, under current U.S. law, the VOCC's are provided the advantage of being able to enter into confidential service contracts with beneficial cargo owners. Nevertheless, the mega-NVOCC's appear to be faring particularly well under current U.S. law. The ability of VOCC's to enter into confidential service contracts with their shipper customers helps to maintain a direct relationship between carrier and shipper. Should NVOCC's be given a similar ability to enter into confidential service contracts as requested by several of the petitions to the FMC, there is a serious risk that the mega-NVOCC's, who have already achieved significant market power, may be able to use this new freedom to disconnect the direct relationship between ocean carriers and their shipper customers.

NVOCC's that already have significant market power would see that power further increased by their ability to now deal directly with beneficial cargo owners for ocean transportation on a confidential basis. The mega-NVOCC's would be in a position to take the aggregated bargaining power of dealing with multiple shipper accounts (perhaps totaling well above the 292,000 TEU volume that Wal-Mart, the largest U.S. shipper, imported in 2002[8]) and use that power to drive down the prices the mega-NVOCC's pay for ocean transportation provided by the VOCC's. The potential adverse effects of this disconnection of the VOCC's from their shipper customers and the insertion of the NVOCC's as an intermediary layer in that relationship need to be carefully examined before any changes in the current regulatory environment are entered into.

The disconnection of the direct relationship between VOCC's and their shipper customers by the mega-NVOCC's would be facilitated by the dependence of some ocean carriers on NVOCC's as a sales and marketing channel for a significant portion of their freight. While intermediaries such as freight forwarders and NVOCC's have long played a significant role in the sales and marketing of international shipping services, this role has been balanced and augmented by the carriers' own capabilities to sell their services directly to the shipper as well as using intermediaries as a sales and marketing channel. However, the reliance of ocean carriers on intermediaries as a sales and marketing channel varies between different carriers. Many carriers, such as American President Lines and Maersk Sealand maintain large sales forces. These carriers tend to be providers of premium services that look to attune these services to the particular needs of their customers. Not surprisingly, these carriers have also tended to be leaders of innovation in the industry. Other carriers, particularly state-controlled low cost, low service operators depend more on intermediaries as a sales and marketing channel. By using their bargaining power with this basic service group of carriers that due to government supports and subsidies may be able to operate at less than an adequate level

[8] The Journal of Commerce, September 29, 2003

of profitability for long term survival, the mega-NVOCC's would be able to drive rate levels down for all carriers across the board.

In the absence of a statutory incentive for VOCC's and shippers to deal directly for confidential service contracts, the major international logistics service providers would be able to draw on their singular role as supply chain managers to control the retailing of ocean transportation to their shipper customers thereby contributing to the disconnection of the direct sales and marketing relationship of the ocean carriers and their shipper customers. Mega-NVOCC's such as UPS that serve shippers' transportation and logistics services across a wide variety of areas such as domestic and international package delivery, and domestic transportation and logistics services, may also have an advantage in their ability to "bundle" all such services provided, domestic and international, by ground, air, and sea modes plus warehousing and distribution, into a comprehensive service offering that may permit cross-subsidization of some elements of the service package in order to gain control of the shipper's whole account.

Under current U.S. regulations as prescribed by the Shipping Act, beneficial cargo owners may also have direct relationships with third party logistics services providers acting as NVOCC's for a variety of transportation and logistics services, including ocean shipping, if they so choose. If the shipper purchases ocean transportation directly from the NVOCC, the terms of that ocean transportation service must be publicly filed. The shipper may also contract for ocean transportation services directly with one or more ocean carriers, and in so doing obtain the benefit of confidentiality for any such agreements. As APL pointed out in its comments of October 10, 2003, a logistics company can put together a combined package of ocean shipping and logistics services agreements that can be kept confidential by bundling confidential service contracts between shipper and VOCC with confidential logistics contracts between shipper and NVOCC with the intermediary also able to serve as a shippers agent in negotiating the ocean contract with the VOCC and receiving cargo tendered under that contract.

It should be noted that several ocean carriers have corporate affiliates that provide the type of logistics services being offered by intermediaries to shippers. APL Logistics, Maersk Logistics, and NYK Logistics are examples of sister companies to ocean carriers that have developed significant scale and depth in logistics services. However, these logistics and shipping company affiliates tend to operate as independent profit centers, usually dealing with their corporate partners on an "arms length" basis. This is a fact clearly recognized in C. H. Robinson Worldwide Inc.'s petition to the FMC: "In other words, it is clear that the Maersk Sealand, Inc. ("MSL") assets (chartered and owned vessels) are minimally relied on in the delivery of services for Maersk-Logistics, since Maersk-Logistics requires the chartered and owned vessels of at least 19 other ocean carriers to deliver its services."'

Many shippers are reluctant to "put all their eggs in one basket" by utilizing a single shipping company for a variety of reasons including the desire to retain competition among service providers, to maintain scheduling flexibility, and to avoid potential supply chain disruptions due to labor unrest and other types of service breakdowns. Accordingly, such carrier-affiliated logistics services providers are generally required by their customers to act as a neutral party, using other carriers' services in addition to their partners on behalf of their shipper customers. As noted in APL's October statement to the FMC, carrier-affiliated logistics service providers, like other NVOCC's, do not enter into confidential service contracts with shippers for ocean transportation, but instead work with the shippers' separate cargo contracts with carriers.

Changing the Competitive Balance

There exists a strong possibility that the exemption of the mega-NVOCC's from the Shipping Act's prohibition on entering into confidential service contracts with shipper customers would not contribute to a "leveling of the playing field," as some have claimed, but would rather contribute to a major competitive imbalance in the retail market for shipping services to the significant detriment of VOCC's. VOCC's and NVOCC's are fundamentally different entities. It could be argued that they are not even on the same "playing field." VOCC's must make investments in the billions of dollars in

[9] *Petition of C.H. Robinson Worldwide, Inc. for Exemption Pursuant to Section 16 of the Shipping Act of 1984 to Permit Negotiation, Entry, and Performance of Confidential Service Contracts,* FMC Petition No. P 9-03, September 12, 2003, page 16.

ships and related maritime transportation infrastructure to provide the liner shipping services on which a major part of global trade depends. NVOCC's do not make such investments. Under current law, VOCC's are afforded an advantage in their ability to enter into confidential service contracts. NVOCC's, particularly the mega-NVOCC's acting as comprehensive logistics service providers have an advantage in their ability to respond to the total package of logistics needs of shippers on a direct one to one basis. Due to competitive and service factors, VOCC's are almost universally forced to share their shipper customers with other carriers. The role of a lead logistics service provider in managing a shipper's supply chain generally entails an exclusive relationship with the shipper. The respective advantages of VOCC and logistics service provider in the form of a mega-NVOCC are complementary and are recognized in the current regulatory environment. Any alteration in this competitive equilibrium that puts at risk continued investment in the assets needed to transport trade across the oceans needs to be carefully evaluated in terms of the potential impacts of such a development on the United States' interests in international trade, commerce, and national and economic security.

Some may claim that the aggregation of purchasing power for ocean transportation services in the hands of a few mega-NVOCC's could provide a public benefit in driving down the price of ocean transportation for international shippers. However, this would not necessarily be the ultimate outcome for a number of reasons:

1) Such price reductions may not be passed on to the shipping public – many of the mega-NVOCC's are accustomed to substantially larger profit margins than are ocean carriers[10]
2) Lower carrier profitability could act as a disincentive for the carriers to continue to invest in low return shipping assets with consequent tighter capacity utilization actually contributing to higher shipping prices (this issue is explored further in the next section of this report)

[10] For example, UPS's operating margin (EBIT/Revenue) for 'Nonpackage Services" in 2001-2002 was 8.9 percent compared to 3.2 percent for the leading ocean carriers. UPS achieved an operating margin for all its businesses of 13.1 percent in 2001-2002.

3) The enhanced market power of the mega-NVOCC's could drive smaller NVOCC's and freight forwarders out of the industry leading to a reduction in competition and consequent increase in prices to shippers for ocean transportation and related services

If disconnection of the VOCC's direct sales and marketing relationship with their shipper customers was to occur, the liner shipping industry could be rapidly "commoditized" in that shipping services would be sold as a basic commodity with low price being the dominant competitive factor and any value-added to that service being provided by the logistics service providers. Ocean carriers essentially would be relegated to the role of wholesalers of ocean transportation services to a limited number of very large buyers, the mega-NVOCC's. In order to survive as a company selling the undifferentiated commodity of ocean transportation, achieving low cost would be the critical competitive factor. In this environment, any lines having access to a low cost labor base and substantial government support and subsidies would have a major competitive advantage." Shipping lines that are controlled by governments and consequently have access to direct and indirect subsidization of their operations for purposes of those governments' national interests and industrial policies would be substantially advantaged. Losers would be those lines that must compete in open markets for investment capital and sustain an adequate level of profitability based on free and fair market prices for labor and other cost inputs.

These potential developments have serious implications for shippers. In a commoditized ocean shipping market with low cost dictating survival, the drive for scale economies among carriers would likely lead to further shrinkage in the number of carriers leaving shippers with fewer options for ocean transportation. In an environment in which carriers compete only in price there would be little incentive for ocean carriers to provide anything other than low cost service leading to deterioration in ocean carrier service levels affecting schedule reliability and marine safety.

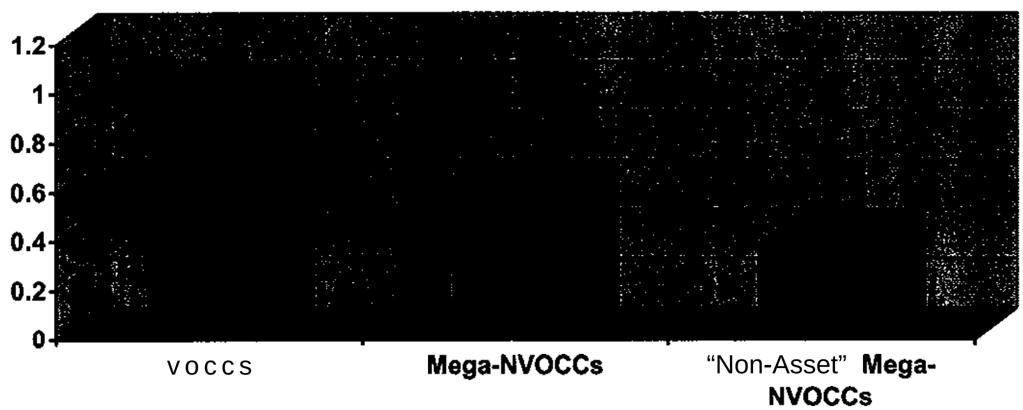
[11] Under the Maritime Security Program, a defined number of U.S. flag vessels are paid an annual stipend that is designed to offset in part the high cost of operating vessels under U.S. registry. The stipend is a fixed amount and does not protect the carrier from losses that may be incurred in unfavorable market conditions nor does it reduce U.S. flag operating costs to parity levels.

III. Effects on Capacity and Related Impact on Rates

VOCC Economics

In order for a company to be a major player in the liner shipping industry, an investment totaling in the billions of dollars is required to build the fleet of vessels, pools of containers and chassis, and port and inland infrastructure of marine terminals and intermodal transportation systems that are needed to transport containerized cargoes around the world. Container shipping is a highly asset-intensive industry as shown in Exhibit 111-l below that compares the ratio of total assets to revenues for sixteen of the largest container shipping lines in the world against the same ratio for eleven leading mega-NVOCC's and eight of the mega-NVOCC's that are 'non-asset" players, meaning that they operate primarily as freight intermediaries using other companies' transportation assets to actually provide services.[12] The shipping lines in the sample represented approximately 67 percent of global container shipping capacity in 2003.

Exhibit III-l
Asset-Intensity of Major Liner Shipping Companies versus Leading Logistics Service Providers (Ratio of Total Assets over Revenues for Year 2002)

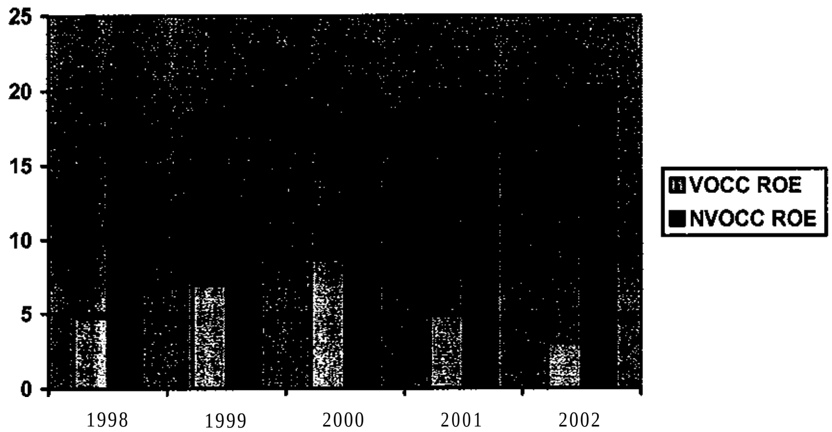


Source: Reeve Associates analysis of company annual reports. VOCC's include APL/NOL, CMA-CGM, CP Ships, CSAV, Evergreen Marine (Taiwan), Hanjin, Hapag Lloyd, Hyundai Merchant Marine, K Line, Maersk (Tankers & Liners), Mitsui OSK Line, NYK Line, OOCL, P&O Nedlloyd, Yangming, and Zim Israel. Mega-NVOCC's include Kuehne & Nagel, Panalpina, UPS, BAX Global, CNF/Menlo Worldwide, CH Robinson, Expeditors International, Schenker/Stinnes Group, Exel, EGL, and Nippon Express.

[12] Top ten carriers excluded from the analysis are Mediterranean Shipping Company and Cosco – these companies do not make financial information publicly available. DHL/Danzas was excluded from the mega-NVOCC analysis as its balance sheet carries large amounts of current assets that are not related to its transportation and logistics businesses.

The average ratio of total assets to revenues for the major ocean carriers is 1 .0. The major part of the carriers' total assets is comprised of ships, containers, and other maritime in&structure. The asset-intensity ratio for the eleven major logistics service providers is 0.6. Their assets include offices, warehouses, and financial investments, as well as trucks and aircraft in some cases, but no maritime transportation assets. When companies such as UPS, BAX Global, and Nippon Express that operate large fleets of non-maritime transportation assets are excluded from the analysis, the level of asset-intensity for the mega-NVOCC's falls to 0.39. The low asset-intensity of the mega-NVOCC's business model appears to have been a significant contributor to their financial performance that has demonstrably outstripped that of the ocean carriers in recent years, as shown in the exhibit below.

Exhibit III-2
Return on Shareholders' Equity of
Major Liner Shipping Companies versus Mega-NVOCC's
(in percent)



VOCC ROE:	4.7%	6.9%	8.7%	4.8%	3.0%
NVOCC ROE:	19.3%	11.7%	20.8%	18.7%	20.3%

Source: Reeve & Associates analysis of company annual reports. VOCC's include APL/NOL, CMA-CGM, CP Ships, CSAV, Evergreen Marine (Taiwan), Hanjin, Hapag Lloyd, Hyundai Merchant Marine, K Line, Maersk (Tankers & Liners), Mitsui OSK Line, NYK Lime, OOCL, P&O Nedlloyd, Yangming, and Zim Israel. Mega-NVOCC's include DHL/Danzas, Kuehne & Nagel, Panalpina, UPS, BAX Global, CNF/Menlo Worldwide, CH Robinson, Expeditors International, Schenker/Stinnes Group, Exel, EGL, and Nippon Express. Financial data includes all businesses of companies in the sample such as UPS's package services and DHL/Danzas's mail and package services.

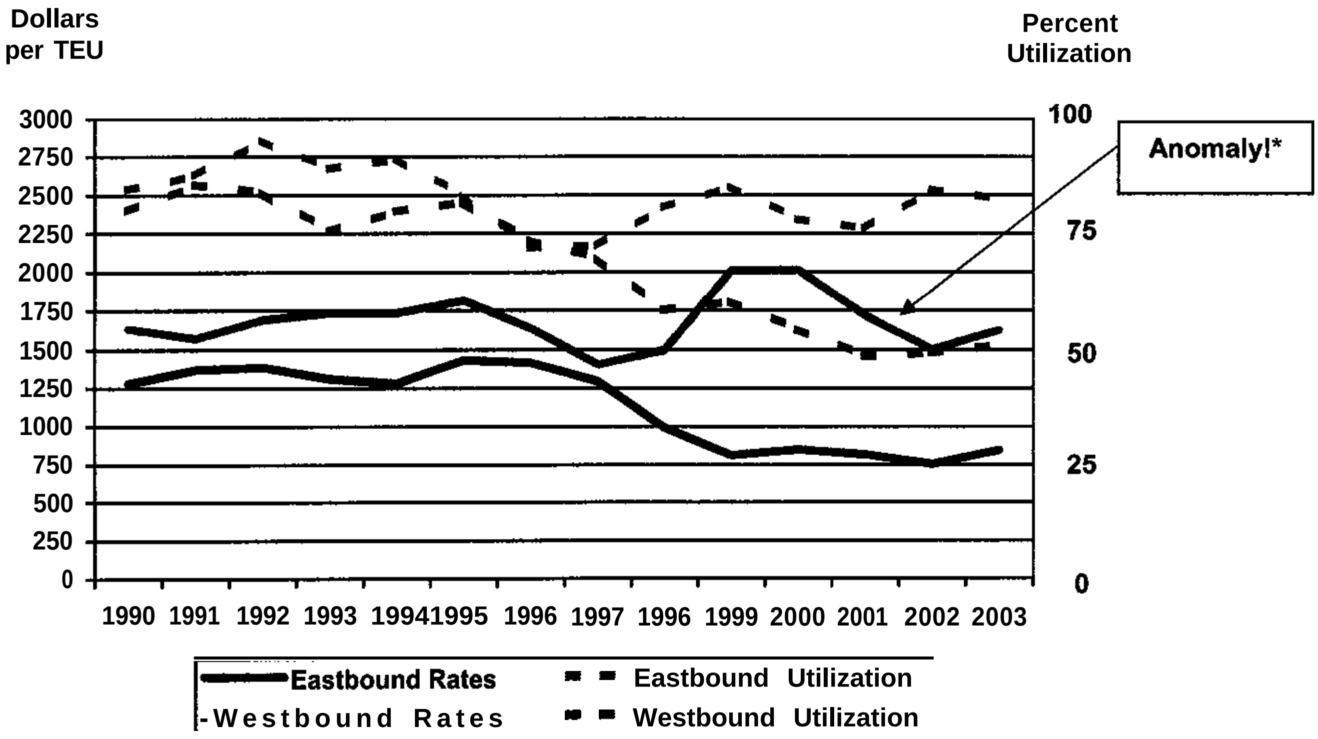
Given the highly asset-intensive nature of container shipping and the possible future prospect of earning the very low returns that characterize liner shipping on any future investment (on top of the estimated $90 billion investment already invested by the industry), in the event of further squeezing of carrier profits from the increase in mega-NVOCC market power occasioned by their exemption from the current prohibition on their entering into confidential service contracts with beneficial cargo owners, there is a reasonable likelihood that many carriers would opt out of the industry altogether or significantly ration their investment exposure. Such a series of events would very likely contribute to a shortage of capacity in ships, containers, and terminals. This shortfall in transportation capacity could negatively impact the flow of trade. In such a case, shippers would not have any recourse to NVOCC's to make the required investments in new capacity. It is possible that in the long term such a shortage of capacity would ultimately drive upwards the price of ocean transportation services, a cost increase that may well be passed through by the mega-NVOCC's to their shipper customers.

As the container shipping industry operates under normal economic rules with the balance of supply and demand having a major impact on rate levels, this tightening of capacity could help drive freight rate levels upward in the medium to long term. The close relationship of freight rates and capacity utilization was recognized by the FMC in its report reviewing the performance of the industry subsequent to the enactment of the Ocean Shipping Reform Act of 1998.[13] Clear evidence of the close relationship of vessel utilization to freight rate levels in the United States' two largest container trades (the transpacific trade with Asia and the transatlantic trade with Europe) is provided in the following two exhibits.

[13] Federal Maritime Commission, *Impact* of the Ocean Shipping Reform *Act of* 1998, published September 2001, page 11

Exhibit III-3

Transpacific Container Freight Rates versus Carrier Utilization

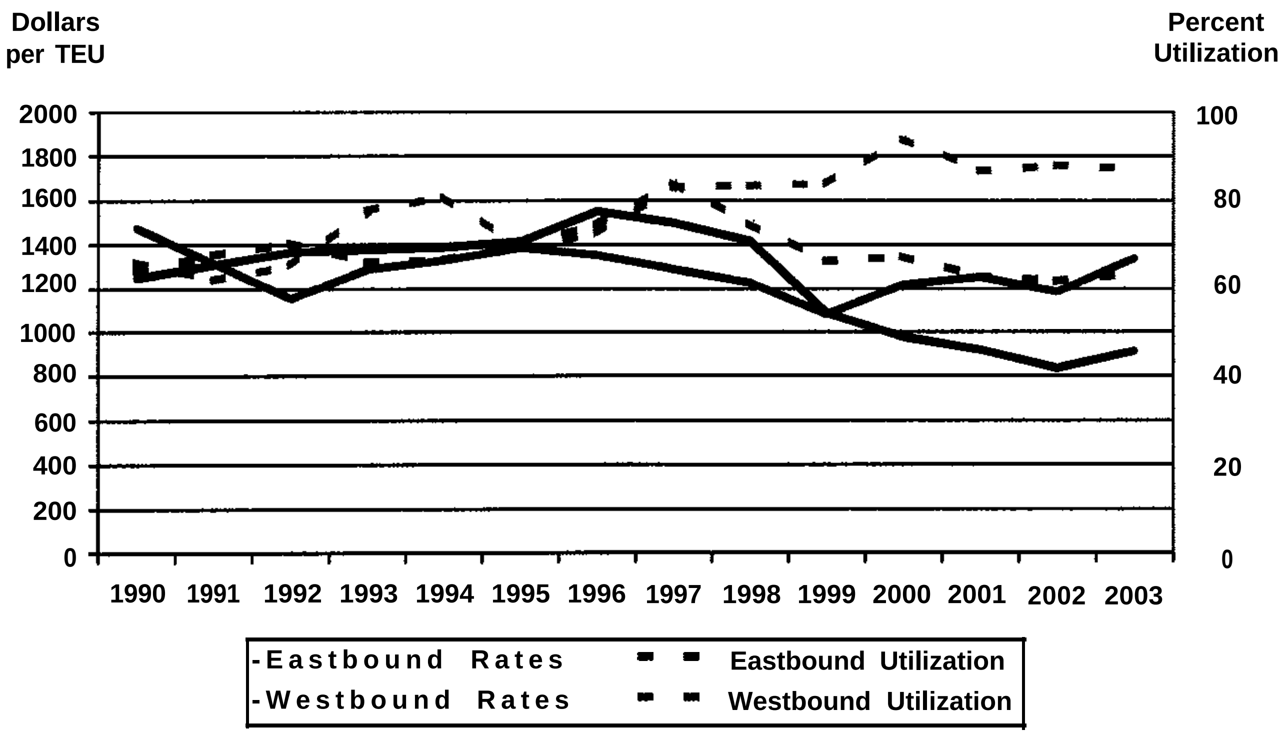


Source: Reeve &Associates analysis, H. P. Drewry

*Transpacific carriers misread future market conditions in the eastbound trade in 2002 when the prevailing opinion was that large increase in vessel capacity would be in excess of growth in trade volumes. As the graph indicates, the growth in trade volumes was sufficient to more than absorb the capacity increases. To the detriment of the carriers, the majority of the their business had already been locked in by 6-12 month contracts that were not renegotiable until 2003.

Exhibit III-4

Transatlantic Container Freight Rates versus Carrier Capacity Utilization



Source: Reeve.& Associates analysis, H. P. Drewry

Both of the exhibits demonstrate a close correlation between freight rate levels and capacity utilization on the respective directions of the trades, particularly in the "backhaul" lanes of the westbound segment in the transpacific trade and the eastbound segment in the transatlantic. Headhaul rates also need to reflect market conditions and capacity utilization on the backhaul segment as well as the headhaul lane. As shown in the two exhibits above, low backhaul utilization drives down rates in that lane to well below headhaul levels. Low backhaul rates and limited backhaul cargo volumes mean that carrier revenues in that direction do not cover costs for that segment. The more unbalanced a trade, the more the headhaul revenues need to take up the slack created by a weak backhaul market.

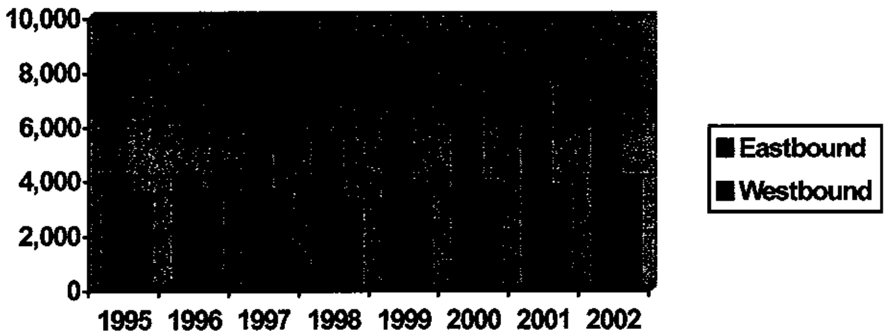
An important distinction between VOCC's and NVOCC's is that the latter do not have to concern themselves with obtaining revenue to cover all segments of a vessel service. As most shippers tend to be interested in only a single direction of trade (i.e. either an importer or exporter), NVOCC's may "cherry pick" those trade segments they wish to serve based on their own and their customers' requirements, taking advantage of higher revenue and margin opportunities for themselves in headhaul markets while leaving carriers to fend for themselves in less attractive backhaul trade lanes. Of course, as NVOCC's do not incur the carriers' total system costs, they are also in a position to take advantage of low backhaul rates by buying space in bulk from the VOCC's and then reselling it at a profit to their shipper customers.

Ocean carriers typically do not have the luxury of committing variable levels of capacity to the different directions of a trade in order to reflect trade imbalances. Vessels in liner shipping operate on regular schedules and must turn within a cycle that essentially places as much capacity on the backhaul as on the headhaul segments. As demonstrated by the following exhibit, the gap between headhaul and backhaul segments in the transpacific and transatlantic trades has widened considerably in recent years.

Exhibit III-5

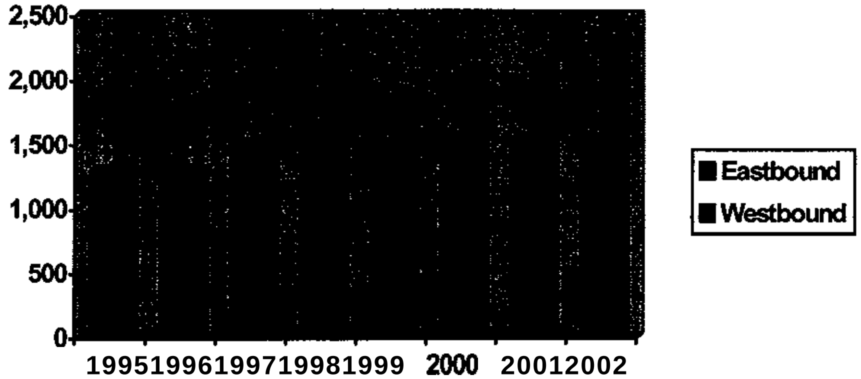
Transpacific Container Volumes by Direction

(In Thousands of TEU)



Transatlantic Container Volumes by Direction

(In Thousands of TEU)



Source: Drewry Shipping Consultants

Carrier results over the last five years have been significantly impacted by the their inability to fully cover all costs, particularly those created by massive trade imbalances in such markets as the transpacific. This has contributed to the poor ocean carrier financial performance in recent years.

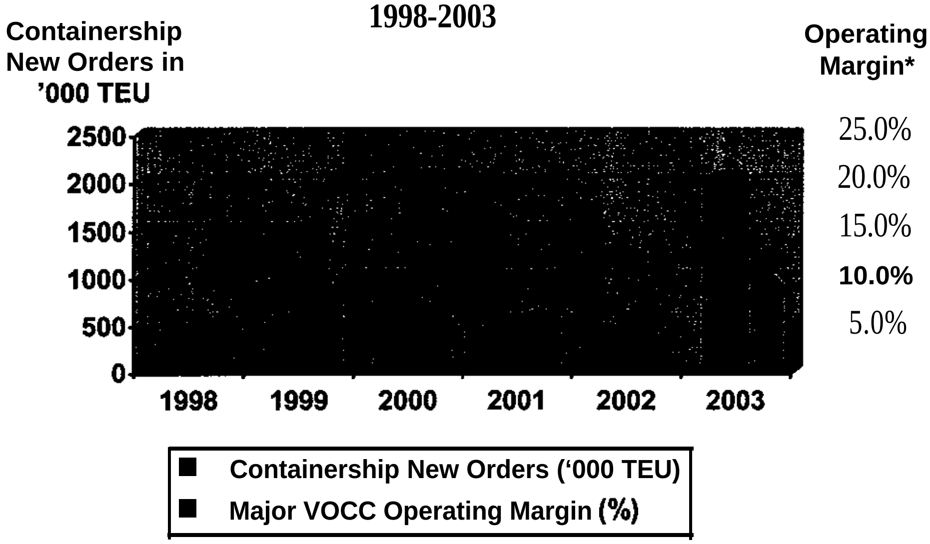
The Relationship between Carrier Earnings and Investment in New Capacity

Carriers subject to market discipline order new vessel capacity in anticipation of market growth and in the expectation of receiving an adequate return on their investment. As shown in Exhibit III-6 below, during 1999-2000, the two recent years in which carriers achieved somewhat improved levels of earnings (as measured here by their operating margin compared to the operating margin of the previous year), orders for new containerships each year increased substantially, rising by 34.6 percent in 1999 and by 77 percent in 2000. However, as carriers' margins deteriorated in 2001-2002, the volume of new contamersbip orders also declined dramatically. Based on preliminary data, carriers' earnings have improved substantially in 2003 in conjunction with an improvement in rate levels on the major trades and continued relatively high vessel utilization on headhaul trade segments. This improvement has been accompanied by a large increase in new vessel orders.

Exhibit III-6

New Containership Orders versus VOCC Operating Margins

1998-2003



Sources: Clarksons Research for containership orderbook, Reeve & Associates analysis of major VOCC financial reports for operating margin
* Operating margin = Earnings Before Interest & Tax/Revenue

It may be reasonably anticipated that a prolonged period of low earnings for the carrier industry could lead to an ongoing shortfall in the addition of new capacity, not only for vessels but also for terminals and other maritime transportation infrastructure.

In summary, VOCC's are required to make huge investments in the assets needed to transport international trade. Their willingness to continue to make such investments may be significantly negatively impacted if VOCC's are entering into an environment in which their opportunity to make an adequate profit is even worse than their recent experience due to the increased market power of mega-NVOCC's if they are permitted to enter into confidential service contracts with beneficial cargo owners.

IV. Effects on Innovation in the Shipping Industry

Container shipping is arguably one of the great industrial innovations of the twentieth century. Healthy competition, the attractiveness of the industry to such new entrants as Malcolm McLean, the founder of containerization, and the desire of carriers to differentiate themselves to their shipper customers all helped foster innovation in global shipping services. The great wave of innovation began with the development of containerships and the carriage of cargo over land and sea in containers, the development of specialized containers to handle such cargoes as refrigerated foodstuffs and bulk chemicals as well as "high cube" containers of 45 feet length or longer for such goods as wearing apparel and electronic equipment, the extension of ocean transportation into intermodal transportation through such developments as the doublestack container rail car, and the development of highly efficient marine container terminals. To a significant extent, APL has been at the forefront of innovation in container shipping.

Ongoing innovation in the physical assets supplying international shipping services will continue to play an important role in supporting international trade and economic development – in areas such as more efficient vessels and cargo-handling and intermodal equipment. It is the VOCC's who must be the source for this innovation, if it is to occur. One cannot look to the NVOCCs that do not invest in the hard assets of shipping to be the drivers of innovation in this area, and nor, perhaps, to the state-controlled carriers in the industry who have tended to not be drivers of innovation within liner shipping in the past.

As noted in the prior section of this report, liner shipping is a highly asset-intensive business. Of the roughly $90 billion in total assets carried on the industry's books in 2002, $52 billion was invested in the physical assets required to transport cargo across the oceans.[14] The largest container shipping company in the world, Maersk Sealand, with revenue in 2002 of $11.6 billion from "container shipping and related activities," carried on its books $6.9 billion of "fixed assets" in that segment of its business covering its investment in containerships,

[14] Based on Reeve & Associates analysis of the balance sheets of APUNOL, CMA-CGM, CP Ships, CSAV, Hapag-Lloyd, Hyundai, K Line, Maersk Sealand, Mitsui OSK Line, NYK Line, OOCL, P&O Nedlloyd, and Yangming – these carriers collectively account for 54 percent of global container shipping capacity

containers, and marine terminals. Similarly, Neptune Orient Lines Limited (NOL), the parent company of which the liner shipping company APL is the major part, on revenue of $4.6 billion in 2002, NOL had total assets of $4.8 billion, $3.2 billion of which was invested in fixed assets such as ships, containers, terminals, and other operating equipment.[15]

The outlook for continued innovation and investment in the assets needed to maintain the container shipping industry as a critical element of the global trading system is made problematical by the threat of commoditization of the industry and the relegation of shipping companies to wholesaler status by the potential emergence of a small group of mega-NVOCC's. As noted earlier, exemption of these entities from the prohibition on confidential service contracts may lead to the disconnection of the ocean carriers from direct sales and marketing contacts with beneficial cargo owners. This disconnection may effectively eliminate or significantly dilute the direct customer feedback that in the past has helped foster innovation by the shipping companies.

Direct carrier-shipper relationships in the past have helped drive innovation within liner shipping from the implementation of "door-to-door" intermodal transportation to the development of specialized containers for such cargoes as refrigerated foodstuffs, high value apparel, and vehicles. The disconnection of direct carrier-shipper relationships could lead to a significant negative impact on such innovation in the future. Innovation also requires investment-as noted earlier in this report, reduced VOCC earnings due to an increase in mega-NVOCC market power could lead to reduced investment in the industry by VOCC's with a consequent negative effect on innovation. It is unlikely that the NVOCC's would be able to (or even have the incentive to) take up the challenge for ongoing innovation in the industry, particularly where such innovation would be in areas associated with major investment in physical assets such as ships, container equipment, mtermodal systems, and marine terminals.

[15] Sources: Annual reports of A.P. Moller and NOL Group

V. Effects on National Security

Commercial container shipping services operating under the U.S. flag provide a critical component of the United States' national defense resources as well as protecting our interests in intemational trade. The U.S. Department of Transportation's Maritime Administration describes this role succinctly: 'The continued existence of a privately owned U.S.-flag merchant marine is vital to the Nation's military and economic security. During national emergencies, there is no completely reliable alternative to the U.S.-flag fleet of commercial ships and to the availability of trained U.S. citizen crews.[16]"

Two U.S. Government defense-oriented programs, the Maritime Security Program (MSP) and the Voluntary Intermodal Sealift Agreement (VISA)", provide the Department of Defense (DOD) with access to U.S. flag vessels, U.S. citizen crews, and participating carriers' complete global intermodal transportation networks and capabilities including integrated sea and land transportation, marine terminals, container equipment, and tracking systems. Under MSP, operators of U.S. flag commercial vessels receive payments from the government that partially offset the higher costs of operating under the U.S. flag. MSP vessels are also enrolled in the VISA program that has been described by General Robertson, Commander in Chief of U.S. Transportation Command, as "the cornerstone of sustainment sealift" for military cargoes moving to a war zone.[18] Under VISA, U.S. flag carriers contractually commit to provide shipping capacity and their global terminal and ground intermodal resources to DOD on an increasing level of commitment depending on the scale of the military contingency up to DOD completely taking over vessels and elements of intermodal infrastructure at the highest scale level of a conflict. These resources and capabilities formed a critical component of DOD's logistics services in support of Operation Desert Storm and, more recently, in DOD's major operations in Afghanistan and Iraq. Although the primary role of commercial sealift is to provide "sustainment sealift," the shipment of equipment and supplies to support military forces already deployed in a combat zone overseas, U.S. commercial shipping companies also

---

[16] *U.S. Maritime Administration 2002 Annual Report*, page 9.

[17] The Maritime Security Program was recently reauthorized by Congress, increasing the number of U.S. flag commercial vessels committed to serving the needs of DOD in times of military emergency from 47 to 60.

[18] General Charles T. Robertson, Jr. (USAF), Commander in Chief U.S. Transportation Command, address to the Senate Armed Services Sea Power Subcommittee, 10 March, 1999

participated in the movement of materiel required in the initial "surge" phase of Operation Desert Storm.

Clearly commercial carriers' participation in VISA puts at risk their normal commercial cargo operations in the event of a major military emergency. Their services are also provided to DOD on a very economic basis. It has been estimated by USTRANSCOM that to replace the 40 percent of MSP capacity in ship numbers and 43 percent in TEU capacity provided by the largest participant in the program, Maersk Line, "would cost $9 billion for initial construction and an annual expense of more than $1 billion for operations and maintenance, excluding crewing and support of a comparable intermodal infrastructure.[19]" This additional cost may be compared to the $39.9 million in annual payments that DOD was paying in 2001 for participation of 19 Maersk Sealand containerships in the Maritime Security Program.

Despite the acquisition of virtually all of the internationally trading U.S. shipping companies by foreign corporations in recent years,[20] there remains a significant U.S. -based international liner shipping business in the presence of U.S. subsidiaries of the foreign shipping companies. These companies have U.S. citizen-majority boards of directors and U.S. employees that have the necessary security clearances to allow them to function effectively as providers of essential services to DOD in military emergencies as well as regular participation in Joint Planning Advisory Group (JPAG) meetings with DOD as part of the VISA program. The companies operate U.S. flag vessels manned by U.S. citizens in international trade, and also operate marine terminals and extensive intermodal networks within the United States that are directly connected to similar operations of the parent companies around the globe.

An important issue for consideration is whether these resources and capabilities would continue to be available to the Nation to use in time of military emergency should the impact of carrier disconnection and related effects increase the perceived risk of operating under the relatively high cost U.S. flag (in a potentially commoditized industry in which low cost is a critical criteria for success) as well as making long term commitments of vessels and

---

[19] "Information Paper" attached to letter dated 20 August, 2001 from General Charles T. Robertson, Jr. to U.S. Senator John B. Breaux

[20] These sales include the acquisition of American President Lines by the NOL Group of Singapore, Sea-Land Service by the A.P. Moller Group of Denmark, Lykes Lines by CP Ships of Canada, and Farrell Lines by P&O Nedlloyd of the UK and the Netherlands.

intermodal systems to support the U.S. military in situations where the commitment puts at risk their ability to serve commercial customers. In a situation in which mega-NVOCC's are able to gain a significant increase in market power, it would appear that these U.S. flag shipping operations are most at risk, both from cost and commercial risk perspectives. Such a scenario could leave DOD facing the choice of incurring the huge investments and operating costs suggested by General Robertson or depending on the services of the low cost, barebones service operators that may remain as ocean carriers – carriers that may be controlled partially or wholly by foreign governments with very different policy agenda than serving the United States' military and national interests.

VI. Effects of Elimination of Tariff Publishing

While the principal focus of this report has been on petitioners' proposals to extend the privilege of confidential service contracting with shippers to NVOCC's, the alternative proposal before the FMC that would amount to the total elimination of publicly filed tariffs by NVOCC's, and the consequent elimination of the regulatory scheme associated with maritime transportation tariffs, raises issues and concerns equivalent to those raised by the petitioners' various proposals concerning service contracts. This is because the elimination of the requirement to publicly file tariffs provides NVOCC's, without any investment in maritime transportation assets, with the same significant competitive advantages as would be provided by allowing them to enter into confidential service contracts with shippers.

VII. Conclusions

There are a number of important questions concerning the potential impact on the international shipping industry serving the United States raised by the several petitions before the FMC to exempt NVOCC's from the prohibition currently imposed by the Shipping Act that prohibits NVOCC's from entering into confidential contracts with shippers for ocean transportation. These questions include the following:

- Would such an exemption result in serious economic damage to the VOCC's by substantially cutting them off from direct sales and marketing contacts with their shipper customers (carrier disconnection), transferring that contact to the NVOCC's, the largest of which ("mega-NVOCC's") may be able to use their considerable buying power of ocean freight on a wholesale basis to drive down freight rates paid to the ocean carriers?

- What would the long term impacts of such a development be on the availability and quality of ocean carrier services? Could shippers in the long term be disadvantaged by declining levels of capacity in ocean shipping and supporting marine terminal and intermodal infrastructure, as well as a reduction in the number of carriers participating in the industry and deterioration in their quality of service?

- Would any such disincentive for carriers to continue to invest in shipping assets and related maritime transportation infrastructure in the long term actually increase the price of ocean shipping?

- Would the "chilling effects" of carrier disconnection and low profitability act to stunt continued innovation in the container shipping industry, particularly as it relates to the very large investments in ships and maritime transportation infrastructure that the VOCC's must make and that the NVOCC's do not make?

- Would the national security of the United States be threatened, and at what cost, should present participants in the shipping industry who are also partners of the DOD in the MSP and VISA programs decide that ongoing investment and participation in the shipping industry is unattractive given low financial returns (created by the increased market power of mega-NVOCC's that may be exempted from the Shipping Act's prohibition on entering into service contracts) and the commercial risk of participation in the DOD programs and operation under the U.S. flag ?

Careful analysis of these critical issues deserves the full attention of the FMC before there is any change to current U.S. policy as suggested by the several NVOCC petitions to the FMC.

* * * * * *

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information, and belief.

John G. Reeve
President, Reeve & Associates

Appendix

Resume of John G. Reeve

John G. Reeve

President, Reeve & Associates
79 Wharf Lane
Yarmouthport, MA 02675

Phone: (508) 362-9156 Fax: (508) 362-7992
Email: reeveassocs@comcast.net
Website: www.reeveassociates.com

John Reeve is the president and founder of Reeve & Associates, a management and economic consulting firm based in Yarmouthport, Massachusetts that advises organizations in the public and private sectors on strategy development, economic analysis, and public policy involving international transportation and logistics services.

Mr. Reeve was formerly a vice president of A.T. Keamey in their global transportation practice with responsibility for maritime and intermodal transportation industries. He was also a vice president of Mercer Management Consulting with responsibility for their international shipping and trade practice. Mr. Reeve's experience within the transportation industry includes a number of positions in marketing and operational management with the P&O Shipping Croup in Australia and the U.K.

Professional Experience

Consulting assignments that Mr. Reeve has directed in recent years include the following:

- Strategic restructuring for one of the largest global container shipping companies based in Asia. The project had three major areas of focus: (1) the development of a long term business plan; (2) operational performance improvement; and (3) organizational restructuring to align the company's resources with its new strategic direction

- A comparative analysis of the economics and service levels provided by carriers operating between the U.S. mainland and Puerto Rico with similarly situated international Caribbean and South American trades

- Analysis of the opportunity for logistics services to be integrated into the total service offering of a major North American port that was evaluating the development of a network of water and land feeder services connecting the port to smaller ports and intermodal centers within its regional market area

- Assessment of the relative economics and service performance of a roll-on/roll-off car carrier service versus rail transportation for the transportation of new automobiles and trucks from a manufacturing plant in Mexico to distribution points in the Eastern United States

- Identification of major performance improvement and cost reduction opportunities for a leading container vessel and terminal operator in the Caribbean

- A market and competitive assessment for an Italian container terminal operator looking at the potential of a new container port in Southern Italy to serve as a major hub for containerized cargoes in the Mediterranean, particularly in the Asian trades

- Development of a global deepsea transportation and logistics strategy for a major South African chemicals shipper that focused on building customized strategic relationships with selected carriers and logistics service providers for the worldwide distribution of several product lines

- Development of strategic plans for several ocean and intermodal carriers focusing on such issues as market analysis and resource allocation, optimizing asset utilization and investment, yield management, customer segmentation and the development of specialized services for particular niches

- Operational performance improvement for shipping companies in terms of vessel, terminal, and landside operations, rolling stock management, and overall system network optimization

- Analysis of merger and acquisition opportunities in the container shipping and leasing industries focusing on such issues as strategic fit, valuation, and bid strategies

- Counsel to private and public sector clients on transportation regulatory policy in North and South America, Asia, and Europe – these include projects in Korea focusing on the restructuring of the Korean shipping industry and in Indonesia recommending policies for the development of the domestic shipping sector

- The development of privatization initiatives in the shipping sector in Australia, Latin America, and the Middle East.

- The provision of expert witness testimony in a number of civil and regulatory legal proceedings involving maritime and intermodal transportation and logistics

Education

Amos Tuck School at Dartmouth College, MBA, June 1980. Specialized work focused on marketing and operational issues within the global transportation and logistics services industries
Princeton University, BA (honors) in History, June 1970. Primary focus on Asian economic and political development